Supreme Court, U.S.
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In the

Supreme Court of the United States

CLAUDE M. BALLARD AND MARY B. BALLARD,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE.,

Respondent.

On Petition for a Writ of Certiorari
to the United States Court
of Appeals for the Eleventh Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

In this case, the trial was conducted by a Special Trial Judge employed at will by the Tax Court. The Special Trial Judge was required to create a report of factual and legal findings, but his original report has never been made available to the parties, the public, or the reviewing Article III courts. Instead, his superiors on the Tax Court either overruled his factual findings or persuaded him to change his mind, thus creating a factual finding of tax fraud. This entire process took place off the record, and came to light only in a subsequent conversation between two Tax Court judges and a counsel for another party.

The questions presented are:

1. Whether this secretive process is consistent with the Due Process Clause or the right to effective Article III review?

2. Whether this secretive process is consistent with 26 U.S.C. § 7482, which provides that Article III courts must review Tax Court decisions just as they would decisions of a U.S. district court?

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PETITION FOR A WRIT OF CERTIORARI

Claude M. and Mary B. Ballard respectfully petition for a writ of certiorari to review the judgment of the Eleventh Circuit Court of Appeals in this case.

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. at 1a) is reported at 321 F.3d 1037 (CA11 2003). The opinion of the Tax Court (Pet. App. at 19a) is reported at *Investment Research Assocs., Ltd. v. Commissioner*, 1999 Tax Ct. Memo LEXIS 463, 78 T.C.M. (CCH) 951, T.C. Memo 1999-407 (1999).

JURISDICTION

The court of appeals issued its judgment on Feb. 13, 2003, and denied rehearing on May 5, 2003. Pet. App. 307a. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1) and 26 U.S.C. § 7482(a)(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

U.S. Constitution, Article III:

> The judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish.

U.S. Constitution, amend. V:

> No person shall . . . be deprived of life, liberty, or property, without due process of law.

26 U.S.C. § 7482(a)(1):

The United States Courts of Appeals . . . shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in section 1254 of Title 28 of the United States Code, in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury . . .

Tax Court Rule 183:

Except in cases subject to the provisions of Rule 182 or as otherwise provided, the following procedure shall be observed in cases tried before a Special Trial Judge:

(a) Trial and Briefs: A Special Trial Judge shall conduct the trial of any such case assigned for such purpose. After such trial, the parties shall submit their briefs in accordance with the provisions of Rule 151. Unless otherwise directed, no further briefs shall be filed.

(b) Special Trial Judge's Report: After all the briefs have been filed by all the parties or the time for doing so has expired, the Special Trial Judge shall submit a report, including findings of fact and opinion, to the Chief Judge, and the Chief Judge will assign the case to a Judge or Division of the Court.

(c) Action on the Report: The Judge to whom or the Division to which the case is assigned may adopt the Special Trial Judge's report or may modify it or may reject it in whole or in part, or may direct the filing of additional briefs or may receive further evidence or may direct oral argument, or may recommit the report with instructions. Due regard shall be given to the circumstance that the Special Trial Judge had the opportunity to evaluate the credibility of witnesses, and the findings of fact

recommended by the Special Trial Judge shall be presumed to be correct.

STATEMENT

The IRS alleged that Claude Ballard, a former Prudential real estate executive, committed fraud in various tax years by failing to report personal income. Pet. App. at 41a-42a. According to the IRS, the income in question was "earned" by Mr. Ballard as part of a complex scheme involving two of his friends: the late Burton Kanter, formerly a tax lawyer and law professor at the University of Chicago, and the late Robert Lisle, another real estate executive at Prudential. Pet. App. at 45a-49a. (The appeals of the other two taxpayers resulted in decisions from the Seventh Circuit and Fifth Circuit, as discussed below.)

The consolidated trial of Ballard and the other taxpayers took place over a five-week period in the summer of 1994. Under Tax Court Rule 183, the trial was conducted by a Special Trial Judge named Irwin Couvillion, who was the only judge to hear the witnesses and observe the evidence. Pet. App. at 33a. As a Special Trial Judge, Judge Couvillion has no tenure and is an at-will employee of the Tax Court. *See* 26 U.S.C. § 7443A(a) (providing for appointment of Special Trial Judges at discretion of Tax Court's Chief Judge).

Pursuant to Rule 183(b), Judge Couvillion spent some four years preparing a report of his factual findings and recommended legal conclusions. Uncontradicted record evidence shows that Judge Couvillion's original Rule 183 report included factual findings and credibility determinations that supported the Ballards' innocence and that it found the Ballards and the other parties *not guilty* of tax fraud or underreporting of income. The Rule 183 report was then filed with the Tax Court on September 2, 1998, after which the Chief Judge of the Tax Court assigned the case to

Judge Dawson, who later issued the opinion of the Tax Court. *Investment Research Assocs., Ltd. v. Commissioner*, 1999 Tax Ct. Memo LEXIS 463, 78 T.C.M. (CCH) 951 (1999).

The Tax Court's final opinion, however, found the Ballards (and the other taxpayers) *guilty* of underreporting income and of tax fraud for the years in question. Pet. App. at 265a-66a; 287a-89a; 294a-95a. By the Commissioner's concession at oral argument before the Eleventh and Seventh Circuits,[1] Judge Couvillion's original factual and legal findings had been *changed* under the influence of a Tax Court judge, who were not present at trial and who may or may not have reviewed the 6,000+ page transcript. Thus, what purports to be an opinion *adopting* Judge Couvillion's Rule 183 report, *see* Pet. App. at 33a, was actually an opinion *reversing* his original report.

The Tax Court had never, however, made the original Rule 183 report available to the parties or the public. The Ballards and the other taxpayers filed a series of motions asking that the original Rule 183 report be released, or in the alternative, that the original Rule 183 report be made part of the record for appellate review.[2] The Tax Court denied all these motions.[3]

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1 An audio recording of the *Kanter* oral argument can be found on the Seventh Circuit's website at http://www.ca7.uscourts.gov/farg/arg.fwx?caseno=01-4316&submit=showdkt&yr=01&num=. The Eleventh Circuit does not release transcripts to the parties, but this Court would presumably be allowed access to those materials.

2 In seeking the original Rule 183 report, the Ballards and the other taxpayers relied on an affidavit filed under penalty of perjury by Kanter's counsel, Randall Dick, in which Mr. Dick recounted a conversation in which two Tax Court judges revealed to him that Judge Couvillion's original report had been reversed. *See* Dick Affidavit, Pet. App. at 308a-10a.

3 On August 30, 2000, the Tax Court issued an order signed by Special Trial Judge Couvillion, Judge Dawson and the Chief Judge of the Tax Court denying the third and final motion. It stated:

> Judge Dawson states and Special Trial Judge Couvillion agrees, that, after a meticulous and time-consuming review of the complex record in these cases, Judge Dawson adopted the findings of fact and opinion of Special Trial Judge Couvillion, that Judge Dawson presumed the findings of fact recommended by Special Trial Judge Couvillion were correct, and that Judge Dawson gave due regard to the circumstance that Special Trial Judge Couvillion evaluated the credibility of witnesses.

T.C. Order of Aug. 30, 2000, Pet. App. at 315a.

Notably, however, the Tax Court *never* denied that Mr. Dick's affidavit was accurate, or that Judge Couvillion's original factual findings had been reversed at some point before issuance of the Tax Court's opinion. Nor did the Tax Court take any disciplinary action against Mr. Dick or accuse him of perjury, as it likely would have done had his affidavit been false or inaccurate in any material respect.

On July 24, 2001, Judge Dawson entered the final order of the Tax Court against the Ballards. An appeal was then taken to the Eleventh Circuit on October 17, 2001. Government counsel conceded at oral argument before the Eleventh Circuit that it had *no* evidence to support its original theory that Judge Couvillion had found fraud from the beginning. Instead, the government speculated – in a theory advanced for the first time at oral argument – that even if Judge Couvillion's original Rule 183 report found no fraud, he *later changed his mind* due to an off-the-record, *ex parte* discussion with his employers (*i.e.*, the reviewing judges on the Tax Court). Thus, when the Tax Court purported to "adopt" Judge Couvillion's opinion, it was technically correct in that Judge Couvillion had by then come to disagree with his original opinion.[4]

The Eleventh Circuit's decision was issued on February 13, 2003. *Ballard v. Commissioner*, 321 F.3d 1037 (CA11 2003) (Pet. App. at 1a). The court accepted the government's latest interpretation of this case's events, stating that "there is nothing unusual about judges conferring with one another about cases assigned to them,"

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4 Government counsel advanced the same novel theory in oral argument before the Seventh Circuit.

and that "as a result of such conferences, judges sometimes change their original position or thoughts." *Id.* at 1043. "Whether Special Trial Judge Couvillion prepared drafts of his report or subsequently changed his opinion entirely is without import insofar as our analysis of the alleged due process violation pertaining to the application of Rule 183 is concerned." *Id.*

A petition for rehearing was filed with the court of appeals on March 27, 2003. It was denied on May 5, 2003. Pet. App. at 307a.

Because appeals from Tax Court cases are taken to the circuit court of appeals in which the taxpayer resides, *see* 26 U.S.C. § 7482(b)(1)(A), the Kanter and Lisle appeals went to different circuit courts of appeals. On July 24, 2003, the Seventh Circuit issued its opinion in the companion case of *Estate of Burton W. Kanter v. Commissioner*, No. 01-4316, ___ F.3d ___ (CA7 July 24, 2003) (hereinafter "*Kanter* slip op."). In that opinion, the court found no due process violation in the Tax Court's withholding of the original Rule 183 report. A lengthy dissent by Judge Cudahy, however, argued that the Tax Court's unprecedented lack of transparency created a due process violation in regards to the parties' right to effective appellate review. *Kanter* slip op. at 75-103. Even though the court conducted its review without the benefit of access to the original Rule 183 report, it found the Tax Court's final opinion lacking in evidentiary support for one out of the six main factual issues. *Id.* at 73. An en banc petition is forthcoming in the Seventh Circuit.

The Lisle appeal resulted in a Fifth Circuit opinion that, despite lack of access to the original Rule 183 report exonerating the taxpayers, unanimously concluded that there was not sufficient evidence to conclude that Lisle committed tax fraud. *Estate of Robert W. Lisle v. Commissioner*, No. 01-60639, ___ F.3d ___ (CA5 July 30, 2003). While the Fifth Circuit attempts to avoid creating a direct circuit conflict by suggesting there are evidentiary distinctions between the cases, *id.* at 42 n.39, its holding

nonetheless unavoidably undermines the Tax Court's entire factual theory of the consolidated case, by which Ballard, Lisle, and Kanter supposedly participated in a unified conspiracy to split certain moneys in a 45-45-10 ratio. *See* Pet. App. 295a.

REASONS FOR GRANTING THE PETITION

It is undisputed that, by all the evidence present in the record for this case, Judge Couvillion's original Rule 183 report was changed, as government counsel conceded at oral argument before the Eleventh and Seventh Circuits. Yet the Tax Court has refused to officially notify either the parties or the reviewing Article III court that the result was changed, nor has it ever explained on the record why the fact-findings were changed or what standard of review was applied to the original fact-finder's decision.

The Eleventh Circuit's decision is the first in United States history to hold that because judges frequently discuss pending cases with their peers, they may also discuss and revise *fact-findings* off the record without advising the parties or the reviewing court of the change or providing any reasons for it. *Ballard*, 321 F.3d at 1043. *But see Kanter*, slip op. at 75-103 (Cudahy, J., dissenting). The error is compounded by the fact that in this case the judges are *not* peers, the trial judge is an at-will employee, and, under Rule 183, the employer judge is supposed to perform clear error review on the trial judge's findings. Whether or not Judge Couvillion agreed to change his factual findings, it is unprecedented to hold that a fact-finder (whether a Special Trial Judge, magistrate, jury, or other fact-finder) may confer *ex parte* and in secret with the very judges who are supposed to review the initial findings for clear error.

There are therefore two compelling reasons to grant a writ of certiorari in this case. First, the Tax Court's procedure "has so far departed from the accepted and usual courts of judicial proceedings . . . as to call for an exercise of

this Court's supervisory power." SUP. CT. R. 10(a); *Nguyen v. United States*, 123 S. Ct. 2130 (June 9, 2003).[5] Second, and relatedly, the Tax Court's procedure creates clashes with this Court's precedents as to Article III and the Due Process Clause.

I. The Questions Presented Are Of Manifest National Importance

The implications of this case stretch far beyond the Tax Court context. As Judge Cudahy noted, "If we approve the Tax Court's practice here, are we not suggesting to the whole administrative array of the federal government that it may seek . . . to deny transparency when engaging in like decisional processes?" *Kanter*, slip op. at 76 (Cudahy, J., dissenting).

If approved, the Tax Court's procedure would dramatically undermine the public's confidence in the fairness of the entire system of Article I courts and administrative agencies. *Cf. Nguyen*, 123 S. Ct. at 2139 n.17 (noting that allowing a non-Article-III judge to participate on a panel would "call into serious question the integrity as well as the public reputation of judicial proceedings"). Moreover, to leave the parties and reviewing courts with an incomplete record is a much more serious risk than the formalistic concerns at issue in *Nguyen*. In all cases handled by subordinate fact-finders, the American public should be assured that all fact-finding will be done on the record so that effective appellate review is possible.

Even in the context of Tax Court proceedings, this case is immensely important. Hundreds upon hundreds of

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[5] *See also Lehman Brothers v. Schein*, 416 U.S. 386, 393 (1974) (Rehnquist, J., concurring) ("The authority which Congress has granted this Court to review judgments of the courts of appeals undoubtedly vests us not only with the authority to correct errors of substantive law, but to prescribe the method by which those courts go about deciding the cases before them.").

taxpayers are subject to proceedings before Special Trial Judges, with no requirement that the parties consent (as is the case for trials before magistrates). Yet none of these taxpayers can be confident (1) that the Special Trial Judge's factual findings or credibility determinations will be given due respect; (2) that the Tax Court will perform its review function properly; or, (3) that the Article III review of that process will be effective or even available.

A LEXIS search reveals that between January 1, 1989 and June 25, 2003, there have been *765 reported cases* in which the Tax Court has employed a Special Trial Judge. The date 1989 is significant, because the former practice of the Tax Court *did* provide copies of the Special Trial Judge's report to the parties. This very practice is what made it possible for the parties in *Stone v. Commissioner*, 865 F.2d 342, 347-48 (CADC 1989), to convince the D.C. Circuit that the Tax Court had not correctly applied a clear error standard of review to the Special Trial Judge's initial report. But after that case, the Tax Court, for reasons that have *never been explained* to this date, stopped providing the Rule 183 reports of Special Trial Judges to anyone outside of its own judges and staff, thereby preventing any Article III review of its own review of Special Trial Judge decisions. Judge Cudahy has even suggested that the rule change may have occurred precisely so as to *discourage* appellate challenges, whether by taxpayers or the Commissioner. *Kanter*, slip op. at 85 (Cudahy, J., dissenting).[6]

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[6] Judge Cudahy was unable to discover any public record of the reasons for the rule change. This led him to observe, "Like the process by which an STJ's report is composed and then withheld, I find this rulemaking procedure oddly out of sync with prevailing practices in other areas of the law." *Kanter*, slip op. at 82 n.2 (Cudahy, J., dissenting). He further observed, "I must again note how remarkable it is that not only is the Tax Court unique in the opacity of its process, but it has arrived at this opaque process by abandoning a transparent process — an evolution completely counter to the trend towards transparency in analogous areas of the law." *Id.* at 85.

In *none* of these 765 cases since 1989 have the parties or the appellate courts been provided with a copy of the Special Trial Judge's original Rule 183 report. In every instance, the parties and the Article III courts of appeal are told only that the Tax Court "adopts" the report of the Special Trial Judge. Moreover, Petitioners have been unable, even after extensive searching, to find *any* case since 1989 in which the Tax Court indicated that it modified, altered, reversed, or changed the Special Trial Judge's conclusions in even the most minor respect. Judge Cudahy's research showed similar conclusions: "[I]n the 880-plus Tax Court decisions since 1983 that I could find that involved an STJ report, the Tax Court judge purported to agree with and adopt the opinion of the STJ in *every* instance. Never, in any instance since the adoption of the current Rule 183 that I could find, has a Tax Court judge *not* agreed with and adopted the STJ's opinion." *Kanter*, slip op. at 78 (Cudahy, J., dissenting).

Thus, as Judge Cudahy pointedly observed, "I say with confidence that this degree of unanimity is not only unusual, but impossible in a system of arms-length appellate style review involving 39 independent individuals." *Kanter*, slip op. at 79 (Cudahy, J., dissenting). It is starkly implausible that Special Trial Judges have, for the past 14 years, attained a record of 100% accuracy as to both the facts and the law. *This would be a feat unparalleled in the history of jurisprudence.* The only logical inference is that the Tax Court has continued, just as before 1989, to revise or alter or occasionally reverse the decisions of Special Trial Judges – but now without *ever* notifying the parties, the public, or the Article III court charged with reviewing the Tax Court's decisions.

II. The Tax Court's Structure of Adjudication Violates Due Process

A. The Balancing Test of *Mathews v. Eldridge* Requires Production of the Original Rule 183 Report

The Tax Court's refusal to produce the original Rule 183 report, even to the Eleventh Circuit, violates the famous test of *Mathews v. Eldridge*, 424 U.S. 319 (1976):

> [T]hree factors should be considered in determining whether the flexible concepts of due process have been satisfied: (a) the private interests implicated; (b) the risk of an erroneous determination by reason of the process accorded and the probable value of added procedural safeguards; and (c) the public interest and administrative burdens, including costs that the additional procedures would involve.

Id. at 333.

First, the Ballards have a significant private interest in receiving fair and trustworthy appellate review in a civil fraud case. As Judge Cudahy noted in his dissent, the "quasi-criminal nature of fraud is a more significant private interest than a simple civil determination . . ." *Kanter*, slip op. at 100 (Cudahy, J., dissenting). Moreover, even the Commissioner would in some cases have an interest in gaining access to the original and untouched Rule 183 report. Second, the risk of error is necessarily higher where the appellate court is forced to speculate about what the original fact-finder thought before his views were subject to lobbying or correction by his superiors. As Judge Cudahy said, "The precedents noted in the administrative context . . . clearly demonstrate how valuable preliminary findings are for review in cases like the present one." *Id.* Finally, the

additional cost would be exceedingly minimal - merely the cost of providing the original Rule 183 report to the parties.

The government has yet to claim any legitimate interest in keeping the original report secret. In Judge Cudahy's words, "[T]his entire process of the Tax Court appears designed to extract the efficiencies involved in designating cases to be heard by STJs without having to bear any of the procedural costs traditionally associated with this kind of adjunct decision-making (e.g., transparency)." *Kanter*, slip op. at 102 (Cudahy, J., dissenting).

In short, the three-part *Mathews* test indicates that the Tax Court's secrecy violates Due Process.

B. The Tax Court's Procedure Presumptively Violates the Due Process Clause

The Tax Court's procedure departs from the procedures used in every other state and federal court in America. This dramatic aberration gives rise to a presumptive Due Process violation.

It has long been the rule that a court's adherence to Due Process will be judged in large part by whether its practices are consistent with the rest of the American legal system. *See, e.g., Murray's Lessee v. Hoboken Land & Improvement Co.*, 59 U.S. 272, 277 (1856) (holding that where American constitutional law provides no answer to a Due Process question, the court should look to the "settled usages and modes of proceeding existing in the common and statute law of England"); *Tumey v. Ohio*, 273 U.S. 510, 523 (1927) (same); *Powell v. Alabama*, 287 U.S. 45, 60-66 (1932) (conducting extensive analysis of colonial precedents related to the right to counsel).[7] "As this Court has stated from its

[7] *See also* Sanford H. Kadish, *Methodology and Criteria in Due Process Adjudication – A Survey and Criticism*, 66 YALE L.J. 319, 325-35 (1957) (discussing the Court's use of historical analysis in procedural due process cases).

first due process cases, traditional practice provides a touchstone for constitutional analysis." *Honda Motor Co. v. Oberg*, 512 U.S. 415, 430 (1994). "When the absent procedures would have provided protection against arbitrary and inaccurate adjudication, this Court has not hesitated to find the proceedings violative of due process." *Id.*[8]

Thus, for example, when the Court considered whether Due Process required that criminal violations be proved beyond a reasonable doubt, the Court found that American judicial system's "virtually unanimous adherence" to this standard reflected a "profound judgment about the way in which law should be enforced and justice administered." *In re Winship*, 397 U.S. 358, 362 (1970) (quoting *Duncan v. Louisiana*, 391 U.S. 145, 155 (1968)). In *Duncan*, the Court found a Due Process violation where one state departed from the universal practice of allowing jury trials for serious criminal offenses. 391 U.S. at 155. Similarly, in *Oberg*, the Court held that Oregon had denied Due Process by disallowing any appellate scrutiny of the size of punitive damage awards, basing its holding on the fact that appellate scrutiny was permitted in the federal system and in every state except Oregon. *Oberg*, 512 U.S. at 430.

[8] The opposite is true as well: Where plaintiffs challenge procedures that have been universally deployed, the Court is reluctant to find a Due Process violation. *See, e.g., Burnham v. Superior Court of Cal., County of Marin*, 495 U.S. 604, 611-16 (1990); *Pacific Mut. Life Ins. Co. v. Haslip*, 499 U.S. 1, 17 (1991) (noting that "every state and federal court that has considered the question has ruled that the common-law method for assessing punitive damages does not in itself violate due process"); *Sun Oil Co. v. Wortman*, 486 U.S. 717, 730 (1988) ("'If a thing has been practised for two hundred years by common consent, it will need a strong case for the Fourteenth Amendment to affect it.'") (quoting *Jackman v. Rosenbaum Co.*, 260 U.S. 22, 31 (1922)); *Snyder v. Massachusetts*, 291 U.S. 97, 111 (1934) ("The Fourteenth Amendment has not displaced the procedure of the ages").

As discussed in detail below, the Tax Court's procedure departs in many ways from those used in every other court: It keeps the initial fact-finder's report, the communications relating to it, and any reasons for change, off the record and unavailable to the parties or reviewing courts; it allows the reversal of credibility findings by someone not present at trial; and it allows off the record, *ex parte* contact between a reviewing superior and the putative fact-finder.[9] As Judge Cudahy said in his dissent, the Tax Court avoids "procedural transparency in a circumstance where *every other like process* known to the law is transparent." *Kanter*, slip op. at 76 (Cudahy, J., dissenting) (emphasis added). The Tax Court's practice thus presumptively violates the Due Process Clause.[10]

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9 To be sure, the denial of a traditional procedural safeguard may be excused where the court has adopted an adequate substitute procedure. *Oberg*, 512 U.S. at 430-31. But the Tax Court has not even purported to adopt any procedure that would be an adequate substitute for the traditional practice by which the factfinder's conclusions are, at the very least, made public before they are subject to correction or review by a superior officer.

10 Respondent might point to the fact that there exist few, if any, Due Process precedents that are precisely on point with the current case. Yet this very lack of precedent is further confirmatory evidence that Due Process has been violated. The Court in *Oberg* observed that "[b]ecause the basic procedural protections of the common law have been regarded as so fundamental, very few cases have arisen in which a party has complained of their denial." *Oberg*, 512 U.S. at 430. Similarly, the Court observed in *Burnham* that the reason some jurisdictions lacked precedents on a particular Due Process issue was "because the issue was so well settled that it went unlitigated." *Burnham*, 495 U.S. at 613.

The present case involves principles of similarly unanimous lineage. The reason that there are few direct precedents for Petitioners' argument is precisely because the Tax Court's own practice is without precedent.

1. The Decision Below Conflicts With The Universal Rule That Fact-Finding Must Be Made On The Record

Throughout the entire American court system, fact-finders (whether juries, district judges, administrative law judges, magistrates, or special masters) always make their initial factual findings on the record, whether or not those findings are later subject to change or review.

Juries, for example, always announce their verdict in public *before* the judge can even consider issuing a judgment as a matter of law under FED. R. CIV. P. 50 or any analogous state procedural rule. When federal district courts employ magistrates under 28 U.S.C. § 631 to conduct factual hearings, the magistrates must submit their proposed findings and recommendations for disposition to the Court *and to the parties*. 28 U.S.C. § 636(b)(1)(c) ("[T]he magistrate shall file his proposed findings and recommendations under subparagraph (B) with the court and a copy shall forthwith be mailed to all parties."); *see also* FED. R. CIV. P. 72 and 73.

When federal district courts employ special masters, the rule is the same: the special master must make and file a report, as well as serve it on the parties, FED. R. CIV. P. 53(e)(1), and his factual conclusions can only be disturbed for clear error, *id.* 53(e)(2); *see also* 9A WRIGHT & MILLER, FEDERAL PRACTICE & PROCEDURE § 2614 (2d ed. 1995).[11] And where a bankruptcy judge makes factual findings, these findings are available on the record to the parties and the public before they are reviewed by a federal district judge. *See* STEVEN ALAN CHILDRESS & MARTHA S. DAVIS, 1 FEDERAL STANDARDS OF REVIEW, at § 2.03E (1999).

Similarly, although the factual findings of administrative law judges are subject to review by their

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11 This has long been the rule. *See, e.g., Tilghman v. Proctor*, 125 U.S. 136, 149-50 (1888) (considering exceptions taken to master's factual report); *Callaghan v. Myers*, 128 U.S. 617, 666-67 (1888) (same).

superiors, the original findings are still part of the administrative record. 5 U.S.C. § 557(c) ("All decisions, *including initial, recommended, and tentative decisions*, are a part of the record and shall include a statement of--(A) findings and conclusions, and the reasons or basis therefor, on all the material issues of fact, law, or discretion presented on the record. . . .") (emphasis added).[12]

Thus, in the famous case of *Universal Camera v. NLRB*, 340 U.S. 474 (1951), this Court held that in order to perform "substantial evidence" review of the NLRB's determination, Article III courts had to be able to consider the hearing examiner's *initial report*, even though in that context a statute actually required the "Board" itself to make factual findings. *See* 29 U.S.C. § 160(c). In the Court's words, "[S]urely an examiner's report is as much a part of the record as the complaint or live testimony." *Id.* at 493. "[E]vidence supporting a conclusion may be less substantial when an impartial, experienced examiner who has observed the witnesses and lived with the case has drawn [different] conclusions . . . ." *Id.* at 496.

In sharp contrast to the procedures used in other courts, the Tax Court has refused to make public the original Rule 183 report as filed by Judge Couvillion. The Commissioner's counsel even refused, in the *Kanter* case, to provide a straight answer to a Seventh Circuit judge's question whether the Commissioner would supply that court with a sealed copy of Judge Couvillion's original Rule

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12 Agencies are also forbidden to promulgate rules based on comments or evidence that are kept secret. *See, e.g., Home Box Office, Inc. v. F.C.C.*, 567 F.2d 9, 56 (CADC 1977) ("Equally important is the inconsistency of secrecy with fundamental notions of fairness implicit in due process and with the ideal of reasoned decisionmaking on the merits which undergirds all of our administrative law."); 42 U.S.C. § 7607(d)(6)(C) (Clean Air Act requirement that "(t)he promulgated rule may not be based (in part or whole) on any information or data which has not been placed in the docket . . . .").

183 report - even after the judge explicitly asked to be given a "yes or no" answer.[13]

Fact-finding *on the record* is an indispensable part of our judicial system. The Tax Court's practice conflicts with the practice of every other court in America, and should be struck down.

2. The Decision Below Conflicts With The Universal Rule That Credibility Findings Should Rarely, If Ever, Be Reversed By Someone Who Was Not Present At Trial

The opportunity to observe a witness is necessary to make a meaningful credibility determination. Credibility findings are particularly important in this case, which involved dozens of witnesses, weeks of testimony, and thousands of pages of transcript. As Judge Cudahy said, "I can think of no single item of more significance in evaluating a Tax Court's decision on fraud than the unfiltered findings of the STJ who stood watch over the trial." *Kanter*, slip op. at 99 (Cudahy, J., dissenting).

Because of the fact-finder's unique proximity to the live testimony, his or her decision is always subject to a deferential standard of review, whether he wears the title "judge," "juror" or "special trial judge." It is universally accepted that credibility assessments can only rarely be second-guessed by those who were not present.[14] As this Court stated in *Anderson v. City of Bessemer*, 470 U.S. 564 (1985): "When findings are based on determinations regarding the credibility of witnesses, . . . only the trial judge can be aware of the variations in demeanor and tone of voice that bear so heavily on the listener's understanding of and belief in what is said." *Id.* at 575. "[W]hen a trial judge's

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13 *Kanter* oral argument, *supra* note 1.

14 This is true in all fifty states as well. *See* 5 C.J.S. *Appeal and Error* § 781 (1993).

finding is based on his decision to credit the testimony of one of two or more witnesses, each of whom has told a coherent and facially plausible story that is not contradicted by extrinsic evidence, that finding, if not internally inconsistent, can virtually never be clear error." *Id.*[15]

Thus, in jury trials, a judgment as a matter of law can be rendered against a party only if "there is no legally sufficient evidentiary basis for a reasonable jury to find for that party on that issue." FED. R. CIV. P. 50(a). In bench trials, fact-findings may not be set aside "unless clearly erroneous." FED. R. CIV. P. 52.

Similarly, in *United States v. Raddatz*, 447 U.S. 667 (1980), this Court upheld the constitutionality of the

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[15] *See also Universal Camera*, 340 U.S. at 496 ("The significance of [the hearing examiner's] report, of course, depends largely on the importance of credibility of witnesses."); *Holiday v. Johnston*, 313 U.S. 342, 352 (1941) ("One of the essential elements of the determination of the crucial facts [in any case] is the weighing and appraising of testimony."); *Morgan v. United States*, 298 U.S. 468, 481 (1936) ("That duty cannot be performed by one who has not considered evidence or argument. . . . The one who decides must hear."); *Gottlieb v. Barry*, 43 F.3d 474, 486-87 & n.9 (CA10 1994) (holding that district court must respect a master's determination if it is "similar to a credibility finding"); *United States v. Marshall*, 609 F.2d 152, 155 (CA5 1980) (only in a "rare case" should a district judge resolve credibility choices in manner contrary to recommendation of magistrate who heard witnesses' testimony); *Bennerson v. Joseph*, 583 F.2d 633, 641 (CA3 1978) (district court serves in a reviewing capacity and should not displace master's view of witnesses' credibility); *National R.R. Passenger Corp. v. Koch Indus., Inc.*, 701 F.2d 108, 111 (CA10 1983) (discussing importance of respecting a master's determinations that are "similar to a credibility finding").

For the same reason, where a case has been tried to the bench and the judge who heard the case below is no longer available on remand, the new judge will normally be required to recall and hear each of the witnesses himself. *See, e.g., United States v. Mitchell*, 187 F.3d 331, 332-33 (CA3 1999) ("Because on remand this case must be assigned to a district judge who had not had the opportunity to observe the witnesses either at trial or at the sentencing hearing, we believe that it is better procedure to direct a full sentencing hearing.").

Magistrate's Act only because there was no reason to believe that credibility determinations had been *rejected*. In that case, a federal District Judge had upheld a magistrate's finding that a criminal defendant had confessed voluntarily. In doing so, the Judge had not recalled the witnesses to repeat their testimony. In rejecting due process and Article III objections, a plurality of the Court explicitly noted that the situation would be very different had the District Court *rejected* a magistrate's fact-finding without personally observing the witnesses:

> Neither the statute nor its legislative history reveals any specific consideration of the situation where a district judge after reviewing the record in the process of making a *de novo* "determination" has doubts concerning the credibility findings of the magistrate. The issue is not before us, but we assume it is unlikely that a district judge would reject a magistrate's proposed findings on credibility when those findings are dispositive and substitute the judge's own appraisal; *to do so without seeing and hearing the witness or witnesses whose credibility is in question could well give rise to serious questions* which we do not reach.

Id. at 681 n.7 (emphasis added).[16]

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[16] Indeed, this concern was not only noted by the plurality, it was the central feature of all of the concurring and dissenting opinions. *See id.* at 684 (Blackmun, J., concurring) ("I would distinguish between instances where the district court rejects the credibility-based determination of a magistrate and instances, such as this one, where the court adopts a magistrate's proposed result."); *Id.* at 686-87 (Powell, J., concurring in part and dissenting in part) (arguing that where credibility issues are concerned, the Article III judge must conduct his own hearing of the witnesses whether or not he wishes to reverse the magistrate); *Id.* at 691 (Stewart, J., joined by JJ. Brennan and Marshall) (arguing that the district judge could *never* decide a motion to suppress "without being exposed to the one kind of

A subsequent case confirmed the Court's continuing concern over reversals of credibility determinations. In *Peretz v. United States*, 501 U.S. 923 (1991), the issue was whether a magistrate could lawfully conduct voir dire proceedings in a felony trial. The Court noted that in some cases, the magistrate's determination might "turn[] on the credibility of witnesses." *Id.*at 939. To answer this observation, the Court cited footnote 17 from *Raddatz*: "We presume, as we did in *Raddatz* when we upheld the provision allowing reference to a magistrate of suppression motions, that district judges will handle such cases [i.e., cases hinging on credibility findings] properly if and when they arise. See *id.*, at 681, n. 7." *Id.* In other words, the *Peretz* Court, just as in *Raddatz*, heavily implied that district courts are expected to respect credibility determinations made by magistrates, and indicated that the constitutionality of allowing magistrates in the first place might hinge on such respect being accorded their determinations.

In short, it is the universal practice of American courts that credibility determinations made by a fact-finder, whether a judge or jury, are to be given great respect and are rarely, if ever, to be overruled by another judge who was not present at trial. Yet here the results found by Special Trial Judge Couvillion were changed by or under the influence of Judge Dawson, who was not present at trial and did not observe the witnesses. This Court should not countenance such a departure from traditional procedures of fact-finding.

3. The Decision Below Conflicts With The Universal Prohibition Against *Ex Parte* Contact With The Fact-Finder

In the federal system, trial judges must not discuss fact issues with the jurors before the verdict has been

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evidence that no written record can ever reveal -- the demeanor of the witnesses.").

announced. *See, e.g., United States v. United States Gypsum Co.*, 438 U.S. 422, 460 (1978) ("Any *ex parte* meeting or communication between the judge and the foreman of a deliberating jury is pregnant with possibilities for error."); *Rogers v. United States*, 422 U.S. 35, 38 (1975) (reversing conviction where judge engaged in *ex parte* communications with jurors); *United States v. Cowan*, 819 F.2d 89, 93-94 (CA5 1987) (same); *Fillippon v. Albion Vein Slate Co.*, 250 U.S. 76, 81 (1919) (same); *United States v. Yonn*, 702 F.2d 1341, 1345 (CA11 1983) (discussing significance of adequate record to access role of *ex parte* contact). This prohibition is rooted firmly in due process considerations. *See, e.g., United States v. Frazin*, 780 F.2d 1461, 1469 (CA9 1986) ("*Ex parte* communications from the judge to the jury violate a defendant's right to due process of law.").

Similarly, *every* state judicial system (by rule or court decision) has also prohibited *ex parte* communications between judges and jurors while fact issues are in play.[17]

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[17] *Matthews v. Liberty Mut. Ins. Co.*, 243 So. 2d 703 (Ala. 1971); *Frontier Cos. v. Jack White Co.*, 818 P.2d 645 (Alaska 1991); *Perkins v. Komarnyckyj*, 834 P.2d 1260 (Ariz. 1992); *Coran v. Keller*, 748 S.W.2d 349 (Ark. 1988); *Halada v. Venice Lake Park, Inc.*, 283 P.2d 42 (Cal. Ct. App. 1955); *Kimmins v. City of Montrose*, 151 P. 434 (Colo. 1915); *Aillon v. State*, 363 A.2d 49 (Conn. 1975); *Loatman v. Patillo*, 401 A.2d 91 (Del. 1979); *Sears Roebuck & Co. v. Polchinski*, 636 So. 2d 1369 (Fla. Dist. Ct. App. 1994); *Gibson v. Gibson*, 187 S.E. 155 (Ga. Ct. App. 1936); *State v. Estrada*, 738 P.2d 812 (Haw. 1987); *Rueth v. State*, 596 P.2d 75 (Idaho 1978); *Gale v. Hoekstra*, 375 N.E.2d 456 (Ill. App. Ct. 1978); *Rogers v. R.J. Reynolds Tobacco Co.*, 745 N.E.2d 793 (Ind. 2001); *Ragee v. Archbold Ladder Co.*, 471 N.W.2d 794 (Iowa 1991); *Scales v. St. Louis-San Francisco Ry.*, 582 P.2d 300 (Kan. Ct. App. 1978); *Goode v. Campbell*, 77 Ky. 75 (1878); *Jones v. Black*, 676 So. 2d 1067 (La. 1996); *Greely v. Weaver*, 5 A. 267 (Me. 1886); *Smith v. State*, 505 A.2d 564 (Md. Ct. Spec. App. 1986); *Commonwealth v. DeJesus*, 691 N.E.2d 234 (Mass. Pet. Ct. 1998); *People v. France*, 461 N.W.2d 621 (Mich. 1990); *Booth v. Spindler*, 110 N.W.2d 889 (Minn. 1961); *Boedges v. Dinges*, 428 S.W.2d 930 (Mo. Ct. App. 1968); *Gulf Hills Dude Ranch, Inc. v. Brinson*, 191 So. 2d 856 (Miss. 1966); *State Highway Comm'n v. Dunks*, 531 P.2d 1316 (Mont. 1975); *Taulborg v. Andresen*, 228 N.W. 528 (Neb. 1930); *Isbell v. State*, 626 P.2d 1274 (Nev. 1981); *State v. Bailey*, 503 A.2d 762 (N.H. 1985);

Indeed, state courts often take the view that such conduct is both reversible without objection,[18] and so serious that harm is to be presumed.[19]

The rule is the same in the administrative context, where all *ex parte* contact with an administrative law judge is forbidden, *see* 5 U.S.C. § 557(d) (forbidding *ex parte* contact); *Town of Orangetown v. Ruckelshaus*, 740 F.2d 185, 188 (CA2 1984) ("where agency action resembles judicial action, . . . the insulation of the decisionmaker from *ex parte* contacts is justified by basic notions of due process to the parties involved.") (quoting *Sierra Club v. Costle*, 657 F.2d 298, 400 (CADC 1981)).

In short, all American courts and other tribunals follow the general rule that any person or entity charged with making factual findings must not be subject to any *ex parte* contacts that are designed to influence the outcome of that fact-finding mission. In this case, however, it is

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Guzzi v. Jersey Cent. Power & Light Co., 115 A.2d 629 (N.J. Super. Ct. App. Div. 1955); *Amador v. Lara*, 603 P.2d 310 (N.M. Ct. App. 1979); *Linke v. Savage*, 333 N.Y.S.2d 600 (N.Y. App. Div. 1972); *Sheff v. Conoco, Inc.*, 311 S.E.2d 14 (N.C. Ct. App. 1984); *Kronberger v. Zins*, 463 N.W.2d 656 (N.D. 1990); *Bostic v. Connor*, 524 N.E.2d 881 (Ohio 1988); *Osage Mercantile Co. v. Harris*, 152 P. 408 (Okla. 1915); *Hastings v. Top Cut Feedlots, Inc.*, 590 P.2d 1210 (Or. 1979); *Glendenning v. Sprowls*, 174 A.2d 865 (Pa. 1961); *Amica Mut. Ins. Co. v. Tashjian*, 703 A.2d 93 (R.I. 1997); *State v. Dawkins*, 232 S.E.2d 228 (S.C. 1977); *Gilbert v. Caffee*, 293 N.W.2d 893 (S.D. 1980); *Guy v. Vieth*, 754 S.W.2d 601 (Tenn. 1988); *Conrey v. McGehee*, 473 S.W.2d 617 (Tex. Civ. App.-Houston [14th Dist.] 1971, writ ref'd n.r.e.); *Johnson v. Maynard*, 342 P.2d 884 (Utah 1959); *State v. Loso*, 559 A.2d 681 (Vt. 1989); *Ellis v. Commonwealth*, 317 S.E.2d 479 (Va. 1984); *Iverson v. Pacific Am. Fisheries*, 442 P.2d 243 (Wash. 1968); *Klesser v. Stone*, 201 S.E.2d 269. (W.Va. 1973); *State v. Burton*, 334 N.W.2d 263 (Wis. 1983); *Carlson v. Carlson*, 888 P.2d 210 (Wyo. 1995).

[18] *Smith v. State*, 505 A.2d 564 (Md. Ct. Spec. App. 1986); *People v. France*, 461 N.W.2d 621 (Mich. 1990).

[19] *Rogers v. R.J. Reynolds Tobacco Co.*, 745 N.E.2d 793 (Ind. 2001); *Glendenning v. Sprowls*, 174 A.2d 865 (Pa. 1961); *Guy v. Vieth*, 754 S.W.2d 601 (Tenn. 1988).

uncontested (even by the Commissioner's and the Eleventh Circuit's theory) that various judges of the Tax Court had *ex parte* contacts with Judge Couvillion behind the scenes, off the record, and before any official fact-findings were released to the public.

It is as if a district judge were to accompany a jury during their deliberations and urge them to change their mind on the outcome of the case - all without letting the jury's original and unvarnished thoughts on the factual issues ever be made known. Such a procedure would invariably and unnecessarily give rise to speculation about the legitimacy of the ultimate decision. *Cf. Nguyen*, 123 S. Ct. at 2139 n.17 (noting that allowing a non-Article-III judge to participate on a panel would "call into serious question the integrity as well as the public reputation of judicial proceedings"). No reviewing court would tolerate such a drastic departure from traditional practices. This Court should not tolerate it here.

III. The Original Set Of Fact-Findings Must Be Made Available To The Reviewing Court In Order To Satisfy Article III and 26 U.S.C. § 7482

All parties who come into conflict with the federal government have a right to effective review by an Article III court. Even in so-called "public rights" cases, this Court has upheld the use of Article I courts *only* insofar as the private parties have been given the statutory right to appeal to an Article III court. *See, e.g., Crowell v. Benson*, 285 U.S. 22, 54 (1932) (upholding Article I adjudication of claims under Longshoremen's and Harbor Workers' Act because review by Article III court was possible); *Thomas v. Union Carbide Agricultural Prods. Co.*, 473 U.S. 568, 592 (1985) (upholding Article I adjudication of FIFRA claims because "FIFRA at a minimum allows private parties to secure Article III review of the arbitrator's 'findings and determination' for fraud, misconduct, or misrepresentation."); *Northern Pipeline*

Construction Co. v. Marathon Pipe Line Co., 458 U.S. 50, 85 (1982) (holding that Article III review of the bankruptcy court under the "clearly erroneous" standard was not rigorous enough to save the statute); *Id.* at 70 n.23 (noting that "[even] when Congress assigns ['public rights'] matters to administrative agencies, or to legislative courts, it has generally provided, and we have suggested it may be required to provide, for Article III judicial review"); *Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 833, 853 (1986) (upholding a CFTC adjudicatory scheme after noting that Congress permitted meaningful judicial review).[20]

Effective Article III review requires that the appellate court be able to know what the original and unvarnished factual findings were, as made by the person who conducted the trial. Without a record of a jury's unrevised verdict, for example, no appellate court could possibly conduct an effective review of a trial judge's grant of judgment as a matter of law. This principle is so obvious that citations are unavailable: Before the Tax Court's change in practice in the 1980s, no American court had attempted to keep original fact-findings secret. As Judge Cudahy said, "No court of which I am aware has ever considered the ramifications of an agency's swallowing and refusing to regurgitate a preliminary factual finding in the manner done by the Tax Court here." *Kanter*, slip op. at 99 (Cudahy, J., dissenting).

The statutory requirement applicable to review of Tax Court decisions is similar. Section 7482 of the Internal Revenue Code specifically provides that the courts of appeals are to "review the decisions of the Tax Court . . . *in*

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20 *See also* Richard H. Fallon, *Of Legislative Courts, Administrative Agencies, and Article III*, 101 HARV. L. REV. 916 (1988) (concluding that meaningful judicial review in an Article III court is required by the Constitution); Richard B. Saphire & Michael E. Solimine, *Shoring Up Article III: Legislative Court Doctrine in the Post* CFTC v. Schor *Era*, 68 B.U. L. REV. 85 (1988) (asserting that judicial review by an Article III court is a necessary but insufficient requirement of any delegation of judicial power).

the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury . . . ." *See* 26 U.S.C. § 7482 (emphasis added).

It is beyond dispute that when the courts of appeals review decisions of "district courts in civil actions tried without a jury," they are able to examine the actual fact findings of the district court or any subordinate fact-finder. Under Rule 52 of the Federal Rules of Civil Procedure, the district judge must "find the facts specially and state separately its conclusions of law thereon." Paralleling Tax Court's Rule 183, Rule 52 also requires that "[f]indings of fact . . . shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial to judge of the credibility of the witnesses."

Where a district judge has employed the services of a magistrate or special master in a bench trial, no appellate court would tolerate the district judge's attempt to revise or manipulate the factual findings behind the scenes, without ever letting the appellate court know what the original findings were. It would also be impossible for a district judge simply to keep the master's original findings secret, whether or not those findings had ever been changed. Such actions would be inconceivable, and would make effective appellate review impossible.[21] *Cf. Universal Camera*, 340 U.S.

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21 Indeed, there has long been a debate over what standard of review should be applied by the appellate court where a district court has disagreed with another fact-finder (such as a master). *See Stone*, 865 F.2d at 347-48 (discussing the conflict); STEVEN ALAN CHILDRESS & MARTHA S. DAVIS, 1 FEDERAL STANDARDS OF REVIEW, at § 2.03C (1999) (same). Most courts have held that the appellate court should ignore the intermediate step (i.e., the district court) and review the original fact-finder's results *directly*. *See, e.g., Morris Plan Industrial Bank v. Henderson*, 131 F.2d 975 (CA2 1942) (Hand, J.); *Gottlieb*, 43 F.3d at 486-87 & n.9; *Cook v. Niedert*, 142 F.3d 1004, 1009-12 (CA7 1998); *In re Multiponics, Inc.*, 622 F.2d 709, 723 (CA5 1980); *O'Rieley v. Endicott-Johnson Corp.*, 297 F.2d 1, 4-5 (CA8 1961); *Lines v. Falstaff Brewing Co.*, 233 F.2d 927, 930 (CA9 1956). A few courts, on the other hand, have given more deference to the district court's views. *See, e.g., Milliken Research Corp. v. Dan River, Inc.*, 739 F.2d 587, 592-93 (Fed. Cir. 1984);

at 493 ("[S]urely an examiner's report is as much a part of the record as the complaint or live testimony.").

In *Stone v. Commissioner*, 865 F.2d 342 (CADC 1989), the D.C. Circuit held that the combination of Section 7482 and Tax Court Rule 183 (then labeled Rule 182) required 1) the Tax Court to apply a clear error standard of review to the Special Trial Judge's findings, and 2) the court of appeals to apply clear error review to the Tax Court's own review process. *Id.* at 348. The court said:

> If a simple "preponderance" of the evidence -- half plus a little bit -- suffices to overturn the factual findings of a Special Trial Judge, then it is difficult to see what value or force attaches to the presumptive correctness of that judge's factual determinations, much less the "due regard" owed "to the circumstance that the [Special Trial Judge] had the opportunity to evaluate the credibility of witnesses."

Id. at 347.

In other words, when an Article III court of appeals is reviewing a Tax Court decision, it must assure itself that the Tax Court has not committed any clear error in its own review of the Special Trial Judge's original report. This sort of Article III review is absolutely impossible, however, where the Tax Court refuses to let the court of appeals view the original Rule 183 report. While the Special Trial Judge was the only person in a position to make credibility determinations in a fraud case involving 55 witnesses, the Tax Court refused to make the initial findings of Judge

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United States v. Twin City Power Co., 248 F.2d 108, 112 (CA4 1957). Crucially, however, this entire debate would be absolutely impossible unless everyone took for granted that the appellate court must, at the very least, be informed of what the original fact-finder's conclusions were.

Couvillion available to the Eleventh Circuit, even on a sealed basis. The Tax Court simply declared that "Judge Dawson gave *due regard* to the circumstance that Special Trial Judge Couvillion evaluated the credibility of witnesses." T.C. Order, Pet. App. at 315a (emphasis added). But how much "regard" did Judge Dawson actually give to Judge Couvillion's actual credibility findings (which remain unpublished to this day)? Did he apply the clear error standard? Did he apply that standard correctly? Did he make contrary credibility assessments? If he did, was his assessment based on something that appeared in the record or something else? None of these questions can be answered.

Thus, while Congress and the Constitution have given taxpayers the right to have their case reviewed by Article III judges "in the same manner and to the same extent as decisions of the district courts in civil cases tried without a jury," 26 U.S.C. § 7482, that review cannot meaningfully occur when the Tax Court hides evidence that in any other court would be part of the public record. The Tax Court's procedure is neither what Congress intended, nor what Article III would permit.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully Submitted,

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(any footnotes trail end of each document)

CLAUDE M. BALLARD and MARY B. BALLARD, Petitioners-Appellants, versus COMMISSIONER OF INTERNAL REVENUE, Respondent-Appellee.

Nos. 01-17249, 01-17251, 01-17253, 01-17255, 01-17256, 01-17257

UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

February 13, 2003, Decided

February 13, 2003, Filed

COUNSEL: For Ballard, Claude M., Ballard, Mary B., Appellants (01-17249-GG, 01-17251-GG, 01-17253-GG, 01-17255-GG, 01-17256-GG, 01-17257-GG): Davis, Robert Edwin, Hughes & Luce, LLP, Dallas, TX. Brown, Steven Spencer, Martin, Brown & Sullivan, Ltd., Chicago, IL. Hughes, Vester T., Jr., Hughes & Luce, L.L.P., Dallas, TX. Schenck, David J., Hughes & Luce, LLP, Dallas, TX. Martin, Royal B., Jr., Martin, Brown & Sullivan, Ltd., Chicago, IL.

For Commissioner of Internal Revenue, Appellee (01-17249-GG, 01-17251-GG, 01-17253-GG, 01-17255-GG, 01-17256-GG, 01-17257-GG): Openheimer, Joan I., Washington, DC.

JUDGES: Before HULL, FAY and GIBSON *, Circuit Judges.

OPINIONBY: FAY

OPINION: FAY, Circuit Judge:

Petitioners-Appellants Claude M. Ballard ("Ballard") and Mary B. Ballard n1 appeal the judgment of the United States

Tax Court in which it found that Ballard fraudulently failed to declare and pay income tax on approximately $ 3,200,000. The Tax Court determined that Ballard earned the unreported income through a scheme with Burton W. Kanter ("Kanter") and Robert W. Lisle ("Lisle") to sell influence with Prudential Life Insurance Co. of America ("Prudential") whereby suitors of Prudential would pay Kanter kickbacks in exchange for the influence of Ballard and Lisle, senior Prudential employees. After receipt of the kickback proceeds, Kanter would funnel the proceeds of the scheme to Ballard and Lisle through a complex web of corporations, partnerships and trusts designed to shelter the money from the reporting requirements of the Internal Revenue Code. As a result of the Tax Court's findings, Petitioners-Appellants have been assessed tax deficiencies (including penalties against Ballard) totaling $ 1,318,648.

On appeal, Petitioners-Appellants assert (1) that application of Tax Court Rules of Practice and Procedure Rule ("Rule") 183, which allowed the Tax Court Judge to review the findings of the Special Trial Judge without making the findings of the Special Trial Judge available to the parties, violated their due process rights, and (2) that the evidence adduced at trial is insufficient to support the Tax Court's findings. After extensive review of the record and consideration of oral argument, we find that the application of Rule 183 did not violate Petitioners-Appellants' due process rights and that the evidence is sufficient to support the Tax Court's finding that Ballard received and fraudulently failed to report income.

I. BACKGROUND

A. Facts

The factual underpinning of the case involves allegations by the Internal Revenue Service ("IRS") that Ballard and Lisle sold influence with Prudential's Real Estate Department to

would-be Prudential suitors via Kanter, a well-known tax attorney and University of Chicago Law School professor. Ballard worked for Prudential from 1948 until 1981, and Lisle worked for Prudential from 1950 until 1982. Both Ballard and Lisle worked in Prudential's real estate department which was divided into two divisions: equity operations and mortgage operations. During the years of Ballard's and Lisle's employment, Prudential was one of the largest owners of commercial real estate in the United States. Ballard worked in the equity operations division, ultimately becoming the senior vice-president responsible for all operations, acquisitions, sales and portfolio management of Prudential's equity investments in real estate. Ballard's position afforded him great influence over the choice of builders and contractors for Prudential projects and, resultantly, he could influence or prevent a project from going forward. Lisle worked in Prudential's mortgage operations division, ultimately becoming a vice-president and overseeing the lending of money and buying and building of real estate for Prudential. Lisle had the authority to commit any loan up to $ 20,000,000 and to award construction contracts.

Ballard and Lisle worked out of Prudential's Newark, New Jersey corporate headquarters. In fact, their offices were located next to one another. Further, both Ballard and Lisle worked under Donald Knab ("Knab"), the person in charge of all of Prudential's real estate operations. Knab highly regarded both Ballard's and Lisle's work. Consequently, Ballard and Lisle had great influence with Knab regarding the projects Prudential would pursue.

Ballard and Lisle met Kanter during the early 1970s and they all quickly became personal friends. Thereafter, as the IRS contends, Ballard, Lisle and Kanter proceeded to engage in a

scheme whereby Prudential suitors would pay kickbacks to Kanter for securing Prudential business. Because Kanter himself had no influence over Prudential, in order to secure Prudential business, Kanter would rely on Ballard and Lisle. Specifically, the IRS contends that on five separate occasions, arrangements were made to buy Ballard's and Lisle's influence. n2 For each of these arrangements, following the receipt of kickback proceeds, Kanter would funnel the money to Ballard through a complex web of corporations, partnerships and trusts. As alleged by the IRS, Ballard ultimately would receive kickback proceeds through a number of means including deposit of the funds by Kanter into a corporation completely controlled by Ballard, through sham loans by Kanter to Ballard, or through sham consultant payments to Ballard's family members. n3

As the IRS asserts, in order to facilitate the scheme, Kanter formed Investment Research Associates, Ltd. ("IRA") n4 which acted as the conduit through which all kickback proceeds to Ballard were funneled. IRA itself did not perform any business, had no employees other than bookkeepers and paid no salaries in any years other than minimal amounts from 1979 to 1982. However, IRA did have a controlling interest in various subsidiaries including TMT, Inc. ("TMT"), Carlco, Inc. ("Carlco") and BWK, Inc. ("BWK"). n5

TMT was formed in 1982 and remained inactive until IRA acquired all of its outstanding shares of common stock at the end of 1983. At [*7] that time, TMT issued 150 preferred shares of stock to Ballard's family trust ("the Orient Trust") and in 1984, TMT issued an additional 150 shares of preferred stock to the Orient Trust. The IRS contends that TMT was the personal pocketbook of Ballard exhibited by Ballard's complete control over TMT and its investment decisions as well as the fact that Ballard and his family had signatory authority over TMT's accounts and that TMT's

designated business address was Ballard's personal residence.

By the end of 1983, the IRS contends that IRA had accumulated $ 4,771,445 in payments related to "the Five" and that in 1984, Kanter directed IRA to distribute the accumulated funds and its interest in the Essex Partnership n6 in a 45-45-10 ratio to TMT, Carlco and BWK, respectively. Additionally, the IRS contends that Ballard received unreported proceeds from the kickback scheme in the form of (1) continued distributions by IRA of Essex Partnership proceeds in the 45-45-10 ratio, (2) distribution in the 45-45-10 ratio of installment payments IRA received in connection with a stock repurchase of Property Management Systems, Inc. ("PMS") n7 held by IRA and (3) continued receipt of a portion of payments related to the San Francisco Hyatt Embarcadero Hotel n8.

B. Procedural History

Petitioners-Appellants received Notices of Deficiency from the IRS pertaining to years 1975 through 1982, 1984, and 1987 through 1989, alleging that they owed additional taxes. As to each deficiency asserted by the IRS, the Ballards filed petitions for redetermination in the Tax Court. Pursuant to I.R.C. § 7443A and Rules 180, 181 and 183, the Chief Judge of the Tax Court assigned the consolidated case to Special Trial Judge D. Irwin Couvillion for trial.

At the conclusion of the five-week trial during the summer of 1994, Special Trial Judge Couvillion, in accordance with Rule 183(b), prepared and submitted a written report containing his findings of facts and opinions to the Chief Judge for subsequent review by a Tax Court Judge. In accordance with Rule 183, none of the litigants received a copy of Special Trial Judge Couvillion's report at that time. Thereafter, pursuant to Rule 183(b), the Chief Judge assigned

the case to Tax Court Judge H.A. Dawson, Jr. for his review and final disposition. On December 15, 1999, Judge Dawson issued the opinion of the Tax Court in which the Tax Court both approved of and adopted Special Trial Judge Couvillion's report (T.C. Memo 1999-407; see Investment Research Assoc., Inc. v. Commissioner, 1999 Tax Ct. Memo LEXIS 459, 78 T.C.M. (CCH) 948, 1999 T.C. Memo 406 (1999)), a copy of which was provided to the parties. On July 24, 2001, Judge Dawson entered the final order of the Tax Court against Petitioners-Appellants, assessing tax deficiencies of $ 1,318,648. Of that amount, $ 422,812 is penalties against Ballard pursuant to I.R.C. § 6653(b).

On April 20, 2000, prior to the Tax Court's final order of assessment, the Ballards, joined by the other petitioners, filed a motion requesting access to "all reports, draft opinions or similar documents, prepared and delivered to the [Tax] Court pursuant to Rule 183(b)," or, in the alternative, that the Tax Court either certify the issue for interlocutory appeal pursuant to Rule 193 or make the initial findings part of the record for subsequent appeal to the circuit court. On April 26, 2000, Judge Dawson issued an order denying the motion. In the order, Judge Dawson noted that "[he] gave due regard to the fact that Special Trial Judge Couvillion evaluated the credibility of witnesses . . . and treated the findings of fact recommended by the Special Trial Judge as being presumptively correct." n9 On May 26, 2000, the Ballards, along with the other petitioners, filed a second motion with the Tax Court. The second motion requested that Special Trial Judge Couvillion's original report or other documentation be placed under seal and made part of the record for subsequent appellate review. That motion was denied on May 30, 2000.

On August 22, 2000, the Ballards, once again joined by the other petitioners, filed a motion requesting that the Tax Court reconsider its denial of access to Special Trial Judge

Couvillion's original report or, alternatively, that the Tax Court grant the petitioners a new trial. In support of this motion, an affidavit from Randall G. Dick ("Dick"), attorney for IRA and for Kanter, was filed. In the affidavit, Dick indicated that two unidentified Tax Court Judges approached him and stated that in the original report submitted to the Chief Judge in accordance with Rule 183(b), Special Trial Judge Couvillion concluded that payments made by "the Five" were not taxable to the individual petitioners and that the fraud penalty was not applicable. Furthermore, Dick indicated that the two unidentified Tax Court Judges expressed that "substantial sections of the opinion were not written by Judge Couvillion, and that those sections containing findings related to the credibility of witnesses and findings related to fraud were wholly contrary to the findings made by Judge Couvillion in his report." According to Dick, the two Tax Court Judges stated that the changes to Special Trial Judge Couvillion's findings relating to credibility and fraud were made by Judge Dawson. Finally, Dick indicated that he confirmed what he was told by the two unidentified Tax Court Judges with yet another unidentified Tax Court judge. Apparently, the third unidentified Tax Court Judge confirmed that Special Trial Judge Couvillion's opinion had been "changed." On August 30, 2000, the Tax Court issued an order signed by Special Trial Judge Couvillion, Judge Dawson and the Chief Judge of the Tax Court denying the motion and confirming that, contrary to the contents of the affidavit, the underlying report adopted by the Tax Court is, in fact, Special Trial Judge Couvillion's report.

Subsequently, the Ballards petitioned this court for a writ of mandamus seeking an order directing the Tax Court to provide the Ballards with a copy of the original Special Trial Judge Couvillion report or, alternatively, seeking an order requiring that the Tax Court provide any changes made by Judge Dawson to the original Special Trial Judge Couvillion

report. The petition was denied on October 23, 2000.

II. DISCUSSION

This court reviews decisions of the Tax Court "in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury." Pugh v. Commissioner, 213 F.3d 1324, 1325 (11th Cir. 2000) (quoting I.R.C. § 7482(a)(1)). Additionally, we review Tax Court conclusions of law de novo and findings of fact for clear error. Davis v. Commissioner, 210 F.3d 1346, 1347 (11th Cir. 2000).

A. Due Process

Petitioners-Appellants advance three grounds upon which the application of Rule 183 in this case violated their due process. First, Petitioners-Appellants assert that the Tax Court is the only trial court that mandates that the fact-finder submit the report of findings of fact and opinion to the court for adoption, modification or rejection before making the report available to the litigants. n10 Second, Petitioners-Appellants assert that the Tax Court's abrogation of the universally followed procedure of making known the fact-finder's report prior to any modification raises a presumption of a denial of due process. Petitioners-Appellants' final argument can be further divided into two subparts. First, they assert that although the findings of the Special Trial Judge are entitled to deference under Rule 183, as a result of not making the Special Trial Judge's report available, it is impossible to evaluate the actions of the reviewing Tax Judge thus violating Petitioners-Appellants' due process. Second, they assert that meaningful review of the Tax Court's actions by this court is not possible absent inclusion of the Special Trial Judge's original report in the record.

Although articulated separately, at the basic level,

Petitioners-Appellants' arguments make two points: (1) since the Special Trial Judge is the only official of the Tax Court to hear the presentation of evidence, the Tax Court should not be permitted to reach a conclusion contrary to the Special Trial Judge without re-hearing the evidence and/or an providing the parties an opportunity to be heard; and (2) because the Special Trial Judge's report is not included as part of the record, there can be no meaningful review of the Tax Court's actions per Rule 183(c). Because Petitioners-Appellants' arguments rely upon the same faulty premise, this court will address them jointly.

In short, Petitioners-Appellants' arguments are premised upon the assertion that the underlying report adopted by the Tax Court is not, in fact, Special Trial Judge Couvillion's report. Were that to be the case, we, too, would have significant concerns over the propriety of the process employed in this case. However, contrary to Petitioners-Appellants' assertions, the record as presented to us clearly reveals that the report adopted by the Tax Court is Special Trial Judge Couvillion's report. This critical fact is exhibited in the August 30, 2000 Order signed by Special Trial Judge Couvillion, Judge Dawson and the Chief Judge of the Tax Court. Consequently, Petitioners-Appellants' arguments are simply without merit. n11

Even assuming Dick's affidavit to be true and affording Petitioners-Appellants all reasonable inferences, the process utilized in this case does not give rise to due process concern. While the procedures used in the Tax Court may be unique to that court, there is nothing unusual about judges conferring with one another about cases assigned to them. These conferences are an essential part of the judicial process when, by statute, more than one judge is charged with the responsibility of deciding the case. And, as a result of such conferences, judges sometimes change their original position or thoughts. Whether Special Trial Judge Couvillion

prepared drafts of his report or subsequently changed his opinion entirely is without import insofar as our analysis of the alleged due process violation pertaining to the application of Rule 183 is concerned. Despite the invitation, this court will simply not interfere with another court's deliberative process.

The record reveals, and we accept as true, that the underlying report adopted by the Tax Court is Special Trial Judge Couvillion's. Petitioners-Appellants have not demonstrated that the Order of August 30, 2000 is inaccurate or suspect in any manner. Therefore, we conclude that the application of Rule 183 in this case did not violate Petitioners-Appellants' due process rights. Accordingly, we deny the request for relief and save for another day the more troubling question of what would have occurred had Special Trial Judge Couvillion not indicated that the report adopted by the Tax Court accurately reflected his findings and opinion.

B. Sufficiency of the Evidence

To sustain its fraud determination, the Tax Court found that the evidence clearly and convincingly demonstrated that Ballard received income resulting from transactions with "the Five" and attempted to evade the payment of taxes on that income through conduct designed to conceal, mislead, or otherwise prevent the collection of the appropriate taxes due. The Tax Court's fraud determination was based on: (1) Ballard's business acumen and understanding and appreciation of appropriate tax reporting; (2) Ballard's substantial and consistent failure to report approximately $ 3,200,000 in earned income related to "the Five" over a twelve year period; n12 (3) Ballard's failure to cooperate with the IRS during its audit; (4) Ballard's failure to maintain complete and accurate records pertaining to "the Five"; (5) Ballard's use of a large number of Kanter entities designed

for no purpose other than to confuse and disguise income from "the Five"; and (6) Ballard's false and misleading testimony to the Tax Court.

In response, Petitioners-Appellants argue that the evidence is insufficient to support the Tax Court's finding that Ballard received and fraudulently failed to report income. Petitioners-Appellants advance a number of reasons why we should overrule the Tax Court, however, the question before us is not whether there are strong arguments against the findings of the Tax Court. Rather, the question before us is whether the Tax Court's findings are "clearly erroneous." See Comm'r v. Duberstein, 363 U.S. 278, 291, 80 S. Ct. 1190, 1200, 4 L. Ed. 2d 1218, 1228 (1960); Korecky v. Comm'r, 781 F.2d 1566, 1568 (11th Cir. 1986) (citing Marsellus v. Commissioner, 544 F.2d 883, 885 (5th Cir. 1977); Webb v. Commissioner, 394 F.2d 366, 378 (5th Cir. 1968)). n13 "A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." University of Georgia Athletic Assoc. v. Laite, 756 F.2d 1535, 1543 (11th Cir. 1985) (quoting United States v. United States Gypsum Co., 333 U.S. 364, 395, 68 S. Ct. 525, 542, 92 L. Ed. 746 (1948)).

n11 By innuendo, counsel seem to imply that some improper motive caused these alleged changes in Special Trial Judge Couvillion's original report as compared to the final opinion of the Tax Court. (Appellants' Br. at 5). If Petitioners-Appellants believe that a Tax Court Judge has engaged in neglect of duty or malfeasance in office, this court refers Petitioners-Appellants to I.R.C. § 7443(f) as the appropriate manner by which to address such a circumstance.

Based upon our careful review of the record and consideration of oral argument, we are not left with "a definite and firm conviction that a mistake has been committed." When the conduct of the parties and flow of

money is examined in this case, there is strong support for the Tax Court's conclusion that Ballard earned and received income related to "the Five." The record supports the Tax Court's conclusion that Ballard, Lisle and Kanter entered into an agreement to split proceeds from "the Five" in a 45-45-10 ratio and that Ballard ultimately received his share of those proceeds via direct distributions to TMT, through sham loans by Kanter to Ballard, or through sham consultant payments to Ballard's family members. Furthermore, the Tax Court's fraud determination is strongly supported by the record. While no single indicia of fraud present in this case is determinative, the number and combination of those indicia leave us with an abiding belief that the Tax Court did not clearly err in its fraud determination.

Illustrative of our conclusion is the first of "the Five" transactions involving Weaver and the Embarcadero Hotel in San Francisco, California. Ballard first met Weaver in the late 1960s as a product of joint involvement in the development of the Houston Hyatt Hotel. Thereafter, in the early 1970s, Prudential became involved in a joint venture to build the San Francisco Embarcadero Hotel. The joint venture sought an experienced hotel management company to operate the Embarcadero Hotel and, as it so happened, Lisle was participating in the selection of the hotel management company.

A.N. Pritzker ("Pritzker"), one of Kanter's clients and then Hyatt Corp. ("Hyatt") president, was interested in securing the property management contract on the San Francisco Embarcadero Hotel. Lisle, however, was initially not interested in having Hyatt manage the San Francisco Embarcadero Hotel and was not going to allow Hyatt to bid on the contract. Pritzker was determined to win the management contract for Hyatt and offered to pay Weaver if he, through his connection with Ballard and Lisle, could secure the management contract for Hyatt. Through

Weaver's efforts, Hyatt was authorized to bid on the management contract. Ballard was tasked with evaluating the various proposals submitted and, as it turns out, Hyatt was ultimately awarded the property management contract during a meeting attended by both Ballard and Lisle.

In acknowledgement of Weaver's assistance in securing for Hyatt the San Francisco Embarcadero Hotel management contract, Hyatt entered into an agreement with KWJ (Weaver's corporation) to pay Weaver 10% of its fees on the management contract. The hotel opened in May of 1973. Thereafter, the record reflects Weaver received payments equal to 10% of the fees Hyatt received on the management contract. n14

In 1976, IRA (Kanter's corporation) entered into an agreement to purchase 100% of KWJ's stock. Although the Hyatt agreement was worth millions to Weaver, Weaver agreed to sell his rights in KWJ to IRA for $ 150,000 plus 30% of future Hyatt Payments. n15 During the time Kanter and Weaver were solidifying their deal, Hyatt was in the process of becoming privately owned. Kanter did not want the transfer of the KWJ stock to take place until after Hyatt became privately owned, therefore, Kanter's deal with Weaver was framed as a four-year option to buy Weaver's KWJ stock which allowed for IRA to non-publicly purchase the KWJ shares.

In 1979, following Hyatt becoming privately owned, IRA exercised its option to purchase the KWJ shares. n16 At that time, IRA obtained a net 70% ownership interest in the future Hyatt payments as well as KWJ's net worth of $ 115,084. Hyatt was not informed of the Weaver-Kanter deal and continued to send the annual [*25] payments to Weaver. n17 Upon receipt of payments from Hyatt, Weaver would forward the check to IRA which, either through KWJ

or the KWJ Co. partnership, would then "kickback" Weaver's 30% and deduct the payment as a commission expense. On one occasion, relied heavily upon by the Tax Court in support of its finding of an agreement to split the Hyatt payments between Ballard, Lisle and Kanter, Weaver forwarded the annual Hyatt payment with a letter requesting that Kanter deposit the check and "issue appropriate checks to the participants." n18

The record supports that a portion of the proceeds from the Hyatt contract, as with other proceeds related to "the Five," were ultimately distributed to Ballard through a number of means including direct distributions to TMT, through sham loans by Kanter and various Kanter entities to Ballard, or through sham consultant payments to Ballard's family members. Thus, we agree with the Tax Court that if one follows the circuitous and sometimes obfuscated flow of money for each of "the Five," inevitably, Ballard receives 45% of the proceeds his efforts helped to procure and for which he failed to properly report and pay taxes.

III. CONCLUSION

The decision of the Tax Court is affirmed.

AFFIRMED.

- - - - - - - - - - - - Footnotes - - - - - - - - - - - - - - -

* Honorable John R. Gibson, United States Circuit Judge for the Eighth Circuit, sitting by designation.

n1 Mary B. Ballard is a participant in this dispute solely as a result of having filed joint tax returns with her spouse Claude M. Ballard; therefore, unless otherwise specified, all references will be to Claude M. Ballard.

n2 Referred to as "the Five," the IRS contends that the Ballard, Lisle, Kanter influence scheme resulted in the receipt of payments from the following five individuals: J.D. Weaver, Bruce Frey, William Schaffel, Kenneth Schnitzer and John Eulich.

n3 The IRS alleges that a similar method was employed to funnel proceeds of the scheme to Lisle; however, that case is not before us.

n4 Formed in 1979, IRA was originally incorporated as Cedilla Co. in 1974. For purposes of clarity, however, IRA will be used throughout.

n5 According to the IRS, TMT was a subsidiary of IRA that was controlled by Ballard and was the instrument utilized to provide Ballard with his share of the kickback proceeds. Carlco and BWK were subsidiaries controlled by Lisle and Kanter, respectively.

n6 According to the IRS, the Essex Partnership was formed by Kanter, John Eulich and others as part of the fifth kickback arrangement of "the Five." As alleged, IRA maintained a 26.125% interest in the partnership.

n7 According to the IRS, the PMS stock repurchase pertains to the fourth kickback arrangement of "the Five."

n8 According to the IRS, the first kickback arrangement involved an agreement between the Hyatt Corp. ("Hyatt") and the KWJ Corp. ("KWJ"), a company controlled by J.D. Weaver ("Weaver"), whereby Hyatt, based on Weaver's relationship with

Ballard and Lisle, would pay Weaver part of its annual management fee for his assistance in securing Hyatt the management contract for Prudential's San Francisco Embarcadero Hotel. Thereafter, IRA obtained a 70% interest in Weaver's Hyatt payments. Consistent with the other arrangements, TMT received 45% of the payments IRA received from Weaver.

n9 Rule 183(c) provides in relevant part, "due regard shall be given to the circumstance that the Special Trial Judge had the opportunity to evaluate the credibility of witnesses, and the findings of fact recommended by the Special Trial Judge shall be presumed to be correct."

n10 Petitioners-Appellants contrast the procedures employed by the Tax Court pursuant to Rule 183 with the procedures utilized by Magistrate Judges, Administrative Law Judges and Special Masters. However, for the reasons stated, we find the comparisons to be unavailing.

n11 By innuendo, counsel seem to imply that some improper motive caused these alleged changes in Special Trial Judge Couvillion's original report as compared to the final opinion of the Tax Court. (Appellants' Br. at 5). If Petitioners-Appellants believe that a Tax Court Judge has engaged in neglect of duty or malfeasance in office, this court refers Petitioners-Appellants to I.R.C. § 7443(f) as the appropriate manner by which to address such a circumstance.

n12 The Tax Court determined that approximately $ 1,000,000 of additional income was earned by Ballard

related to "the Five." However, the IRS did not issue notices of deficiencies for the relevant years in which the income was earned, therefore, the Tax Court did not have jurisdiction to determine whether or not the tax related to that income had been underpaid. See I.R.C. § 6214(b).

n13 In Bonner v. City of Prichard, 661 F.2d 1206 (11th Cir. 1981) (en banc), this court adopted as precedent all decisions of the former Fifth Circuit Court of Appeals decided prior to October 1, 1981.

n14 Although not all operating years are within the Tax Court's jurisdiction, the record supports that Hyatt made the following payments to KWJ:

Operating Year	Payment Year	Payment
1973	1974	--
1974	1975	--
1975	1976	--
1976	1977	$ 54,848
1977	1978	$ 60,739
1978	1979	--
1979	1980	$ 171,027
1980	1981	$ 128,671
1981	1982	$ 24 ,717
1982	1983	$ 245,843

In 1983, unbeknownst to Hyatt, KWJ Corp. liquidated and distributed its assets to IRA. In 1984, IRA's subsidiaries TMT, Carlco, and BWK formed the dubiously named KWJ Co. partnership in which TMT (i.e., Ballard) and Carlco (i.e., Lisle) each had a 45% interest and BWK (i.e., Kanter) a 10%

interest. Thereafter, the KWJ Co. partnership received the following payments:

1983 1984 --
1984 1985 $ 295,415
1985 1986 $ 330,376
1986 1987 $ 327,784
1987 1988 $ 281,926
1988 1989 $ 75,396
1989 1990 $ 24,340

n15 In effect, Weaver was giving up 70% of his Hyatt payments for $ 150,000.

n16 The Kanter-Weaver deal provided for an initial payment of $ 10,000 by IRA for the KWJ stock. The remaining $ 140,000 purchase price was to be paid by August of 1980. Since Hyatt paid KWJ $ 171,027 for the 1979 operating year, IRA simply utilized what otherwise would have gone to Weaver to pay off the remaining balance owed. Thus, IRA assumed ownership of KWJ and the multi-million dollar contract with Hyatt for little to no out-of-pocket money.

n17 As stated above, in 1983, unbeknownst to Hyatt, KWJ Corp. liquidated and its assets were distributed to IRA. Thereafter, IRA subsidiaries TMT (i.e., Ballard), Carlco (i.e., Lisle) and BWK (i.e., Kanter) formed the KWJ Co. partnership and continued to receive the Hyatt payments.

n18 The Tax Court concluded and we concur that "the participants" is reference to Ballard and Lisle.

United States Tax Court.
INVESTMENT RESEARCH ASSOCIATES, LTD., and Subsidiaries, et al., [FN1]
Petitioners
v.
COMMISSIONER OF INTERNAL REVENUE, Respondent
No. 25875-90, 23178-91, 26918-92, 20211-91, 1984-92, 22884-93, 21555-91, 19314-92, 25981-93, 43966-85, 3456-88, 26251-90, 45273-86, 32103-88, 20219-91, 31301-87, 16421-90, 24002-91, 21616-91, 16164-92, 25976-93, 33557-87, 23743-92, 712-86, 30830-88, 7557-93, 1350-87, 27444-89.
Dec. 15, 1999.
Randall G. Dick and Jeffrey I. Margolis, for petitioners in docket Nos. 43966-85, 712-86, 45273-86, 1350-87, 31301-87, 33557-87, 3456-88, 30830-88, 32103-88, 27444-89, 25875-90, 26251-90, 23178-91, 24002-91, 19314-92, 26918-92, 25976-93, and 25981-93.
Royal B. Martin and Steven S. Brown, for petitioners in docket Nos. 16421-90, 20211-91, 20219-91, 21555-91, 21616-91, 1984-92, 16164-92, 23743-92, 7557-93, and 22884-93.
Mark E. O'Leary, John J. Comeau, James M. Cascino, Jonathan P. Decatorsmith, James M. Klein, G. Roger Markley, and Pamela V. Gibson, for respondent.

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MEMORANDUM FINDINGS OF FACT AND OPINION

DAWSON, J.
These consolidated cases were assigned to Special Trial Judge D. Irvin Couvillion pursuant to Rules 180, 181, and 183. [FN2] The Court agrees with and adopts the opinion of the Special Trial Judge, which is set forth below.
OPINION OF THE SPECIAL TRIAL JUDGE

COUVILLION, Special Trial J.
In these consolidated cases, respondent determined deficiencies in petitioners' Federal income taxes, additions to tax, [FN3] penalties, and increased interest, as follows:
Investment Research Associates, Ltd., and Subsidiaries
Docket No. 43966-85:

Year	Deficiency	Addition to Tax Sec. 6659(a)
1979	$18,791	$5,637

Docket No. 45273-86:

Additions to Tax

Year Deficiency Sec. 6653 Sec. 6659(a) Sec. 6661
---- --------- -------- ---------- --------
1982 $174,225 $8,711 $49,154 $1,038

Docket No. 30830-88: 1
Additions to Tax

Year Deficiency Sec. 6653 Sec. 6659(a) Sec. 6661
---------- ---------- ---------- ---------- ----------
1983 $595,838 $29,792 $16,767 $134,987
1984 410,317 20,516 – 102,579
FN1. In docket No. 30830-88 the deficiencies in tax determined in the notice of
deficiency are $595,838 and $410,317, respectively, for 1983 and 1984. Page 2
of respondent's opening brief states the deficiencies to be $181,546 and
$123,095, respectively, for 1983 and 1984. The Court assumes that the amounts
stated in respondent's opening brief are in error.

Docket No. 27444-89:

Additions to Tax

Year Deficiency Sec. 6653 Sec. 6661
--- -------- ------- -------
1985 $400,488 $20,024 $100,122

Docket No. 25875-90:

Additions to Tax

Year Deficiency Sec. 6653 Sec. 6661
--- -------- -------- --------
1986 $2,110,643 $105,532.15 $527,660.75

Docket No. 23178-91:

Additions to Tax

Year Deficiency Sec. 6653 Sec. 6661
---- --------- -------- ---------
1987 $5,739,249 $286,962 $1,434,812

Docket No. 19314-92:

Additions to Tax

Year Deficiency Sec. 6651(a)(1) Sec. 6653
---- -------- ---------- --------
1980 $1,304,063 $195,609.45 $65,203.15

Docket No. 25976-93:

Additions to Tax Penalty

Year Deficiency Sec. 6653 Sec. 6661 Sec. 6662(a)
--- -------- ------- ------- --------
1988 $768,025 $38,401 $192,006 –
1989 878,898 – – $175,780

Burton W. and Naomi R. Kanter

Additions to Tax Penalty
--- ------
Docket No. Year Deficiency Sec. 6653 Sec. 6659 Sec. 6661 Sec. 6662
-------- --- --------- -------- ------- -------- -------
712-86 1981 $340,578.00 $17,029.00 $42,682 – –
1350-87 1982 2,086,913.00 104,346.00 – $208,691.00 –
31301-87 1978 476,999.00 – – – – –
3557-87 1980 454,396.00 22,720.00 – – –

3456-88 1979 183,809.37 9,190.47 -- -- --
32103-88 1984 3,825,078.00 191,254.00 -- 949,211.00 --
26251-90 1983 1,150,652.00 57,532.60 -- 287,663.00 --
1986 897,224.00 44,861.00 -- 223,666.00 --
24002-91 1987 1,434,529.00 71,726.45 -- 358,632.25 --
26918-92 1988 523,234.00 26,162.00 -- 130,809.00 --
25981-93 1989 835,847.00 -- -- -- $167,169

Claude M. and Mary B. Ballard
Docket No. 16421-90:

Additions to Tax

Year	Deficiency	Sec. 6653	Sec. 6661
1982	$55,338	$2,766.90	$8,774

Docket No. 20211-91:

Additions to Tax

Year	Deficiency	Sec. 6651(a)(1)	Sec. 6653	Sec. 6661
1984	$981,072	1 $51,3311	$88,788.05	$245,268

FN1. On brief, respondent concedes this addition to tax.

Docket No. 21616-91:

Additions to Tax

Year	Deficiency	Sec. 6653	Sec. 6661
1987	$208,449	$10,422.45	$52,112.25

Docket No. 1984-92:

Additions to Tax

Year	Deficiency	Sec. 6653	Sec. 6659
1975	$23,453	$1,173	--
1976	34,024	1,701	--
1977	11,502	--	--
1978	3,923	--	--
1979	21,630	--	--
1980	92,481	--	--
1981	193,743	9,687	$17,138

Docket No. 23743-92:

Addition to Tax

Year	Deficiency	Sec. 6653
1988	$125,136	$6,257

Docket No. 22884-93:

Penalty

Year	Deficiency	Sec. 6662
1989	$179,924	$35,985

Estate of Robert W. Lisle, Deceased, Thomas W. Lisle and Amy L. Albrecht, Independent Co-executors, and Estate of Donna M. Lisle, Deceased, Thomas W. Lisle and Amy L. Albrecht, Independent Co-executors

Additions to Tax Penalty

Docket No.	Year	Deficiency	Sec. 6653	Sec. 6661	Sec. 6662(a)
20219-91	1984	$827,955	$41,397.75	$206,988.75	--

21555-91 1987 195,498 9,774.90 48,874.50 --
16164-92 1988 109,048 5,452.00 27,262.00 --
7557-93 1989 109,049 -- -- $21,810

In the following cases, respondent determined in the notices of deficiency or asserted in amended answers that the underpayments in tax were subject to increased interest under section 6621(c), formerly section 6621(d): [FN4]
Investment Research Associates, Ltd., and Subsidiaries:

Docket No. Year
--------- ---
43966-85 1979
45273-86 1982

Burton W. and Naomi R. Kanter:

Docket No. Year
---------- ----------
1350-87 1982
33557-87 1980
3456-88 1 1979
32103-88 1984
26251-90 1983, 1986
24002-91 1987
FN1. On brief, respondent concedes that the underpayment attributable to the
disallowed loss from Immunological Research Corp. is not subject to increased
interest under sec. 6621(c), following Estate of Cook v. Commissioner, T.C.
Memo.1993-581.

Claude M. and Mary B. Ballard:

Docket No. Year
------- ----------

16421-90 1982
20211-91 1984
21616-91 1987
1984-92 1975, 1976, 1977, 1978
1979, 1980, 1981
23743-92 1988

Estate of Robert W. Lisle, Deceased, etc.:

Docket No. Year
--------- ---
20219-91 1984
21555-91 1987
16164-92 1988

In amended answers, respondent alleged increases in the deficiencies in tax and additions to tax in the following cases:

Petitioner Docket No. Year(s)
---------- -------- ----------
Investment Research Associates, 45273-86 1982
Ltd., and Subsidiaries 43966-85 1979
Burton W. and Naomi R. Kanter 712-86 1981
1350-87 1982
31301-87 1978
33557-87 1980
3456-88 1979
32103-88 1984
26251-90 1983, 1986
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Claude M. and Mary B. Ballard 16421-90 1982
20211-91 1984
21616-91 1987
1984-92 1975, 1976, 1977

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23743-92 1988
22884-93 1989

Estate of Robert W. Lisle, 20219-91 1984
Deceased, etc. 21555-91 1987
16164-92 1988
7557-93 1989

In the amended answers, respondent alleged that the underpayments in tax with respect to all or, alternatively, with respect to substantial portions of the increased deficiencies in tax were subject to the addition to tax for fraud pursuant to section 6653(b) or the penalty for fraud pursuant to section 6663(a) in the following cases: [FN5]

Petitioner	Docket No.	Year(s)
Investment Research Associates, Ltd. and Subsidiaries	23178-91	1987
Burton W. and Naomi R. Kanter	712-86	1981
	31301-87	1978
	33557-87	1980
	3456-88	1979
	32103-88	1984
	26251-90	1983, 1986
	24002-91	1987
	26918-92	1988
	25981-93	1989
Claude M. and Mary B. Ballard	16421-90	1982
	20211-91	1984
	21616-91	1987
	1984-92	1975, 1976, 1977
		1978, 1979, 1980
		1981

	23743-92	1988
	22884-93	1989
Estate of Robert W. Lisle, Deceased, etc.	20219-91	1984
	21555-91	1987
	16164-92	1988
	7557-93	1989

Introduction

In each of the cases in which fraud is alleged, respondent alleged that, if the Court holds that the underpayments in tax are not subject to fraud additions, alternatively, the underpayments in tax are subject to additions to tax under sections 6653(a)(1) and (2) and 6659(a), and the increased interest under section 6621(c), or if the underpayment is for 1989, that it is subject to a penalty under section 6662.

In all of the amended answers in which respondent asserted increased deficiencies in tax, as well as increased additions to tax and penalties, respondent did not calculate or assert the amounts of the increased tax deficiencies or the amounts of the additions to tax or penalties. Respondent asserted only the amounts of increased income or the amounts of disallowed expenses that would result in increased deficiencies in tax and additions to tax. As a result of these amended answers, and as a result of numerous concessions and stipulations of settlement that were made by the parties before, during, and after the trial, as well as concessions of certain issues by respondent on brief, Rule 155 computations will be necessary in some of the cases. [FN6]

These cases are part of a larger group of cases that have also been identified by respondent as a litigation project. The sobriquet for this project is "Levenfeld/Kanter". These cases were selected for trial because, as the Court understands, they involve common issues that the other cases in this project do not have.

References to Kanter, Ballard, and Lisle are to Burton W. Kanter, Claude M. Ballard, and Robert W. Lisle, respectively.

Reference to the Kanters, Ballards, and Lisles are to Burton W. and Naomi R. Kanter, Claude M. and Mary B. Ballard, and Robert W. and Donna M. Lisle, respectively.

The issues to be decided are:

(1) Whether payments made by the Five in the Prudential, Travelers, and Kanter transactions during the years at issue are properly taxable to Kanter, Ballard, and Lisle, and, if so, whether they are liable for the fraud additions to tax and penalty with respect to such income;

(2) whether certain commitment fees paid to Century Industries, Ltd., are includable in Kanter's income for 1981, 1982, 1983, 1984, and 1986;

(3) whether Kanter received unreported income from Hi-Chicago Trust for 1981, 1982, and 1983;

(4) whether Kanter is taxable on the income of the Bea Ritch Trusts for 1986, and 1987;

(5) whether Kanter had unreported income for 1982, 1983, 1984, 1987, 1988, and 1989 from the CMS Investors Partnership;

(6) whether Kanter had unreported income in 1983 from Equitable Leasing Co., Inc.;

(7) whether Kanter had unreported income in 1982 based on the bank deposit analysis method;

(8) whether Kanter received barter income from Principal Services in 1988 and 1989;

(9) whether the Kanters are entitled to certain deductions claimed on Schedule A and Schedule C for 1986 through 1989;

(10) whether Kanter, in 1983, realized capital gains under section 357(b) and (c) from the assumption by Cashmere Investment Associates, Inc., of partnership interests having negative capital accounts and whether, under section 453, the installment method was available for the reporting of such gains;

(11) whether Kanter is entitled to research and development and business expense deductions from Immunological Research Corporation for 1979;

(12) whether Kanter had unreported partnership income for 1978;

(13) whether the Kanters are entitled to a loss from GLS Associates for 1981;

(14) whether the Kanters are entitled to a loss from computer leasing transactions involving Equitec for 1983 and 1984;

(15) whether the Kanters are entitled to investment interest expense deductions for 1981;

(16) whether the Kanters are entitled to an investment tax credit carryover for 1978;

(17) whether the Kanters are entitled to an interest deduction for 1986;

(18) whether the Kanters received unreported interest income from a bank in 1988;

(19) whether Kanter is entitled to a business loss deduction in 1980 in connection with the sale of a painting;

(20) whether the Kanters are entitled to deduct a claimed charitable contribution of $15,000 to the Jewish United Fund in 1982;

(21) whether the Kanters are entitled to claimed capital gains and losses in 1987;

(22) whether respondent correctly made adjustments to the rental income, depreciation, interest expense, and investment tax credits claimed by Investment Research Associates, Ltd. (IRA) in connection with equipment leasing transactions for 1979, 1980, and 1982 through 1989;

(23) whether IRA is entitled to a claimed loss on Form 4797 of $1,073,835 for 1988;

(24) whether IRA is entitled to a charitable contribution carryover deduction for 1983;

(25) whether IRA is entitled to certain claimed capital losses for 1985;

(26) whether IRA is entitled to claimed bad debt deductions for 1987;

(27) whether IRA is entitled to claimed ordinary losses on sales of notes receivable for 1987;

(28) whether IRA is entitled to certain capital losses for 1987;

(29) whether IRA is entitled to deduct as business expenses amounts paid to J.D. Weaver in 1979, 1981, and 1982;
(30) whether the assessment and collection of the deficiency and additions to tax as to IRA for 1980 are barred by the statute of limitations;
(31) whether IRA is liable for the fraud addition to tax for 1987;
(32) whether assessment and collection of Federal income taxes of Kanter, Ballard, and Lisle are barred by the statute of limitations for some years;
(33) the liabilities of Kanter, Ballard, and Lisle for additions to tax for negligence;
(34) whether the Kanters are liable for the section 6659 addition to tax for 1981;
(35) whether Kanter is liable for section 6661 additions to tax for 1982 through 1984, and 1986 through 1988;
(36) whether Kanter is liable for section 6621(c) increased interest for 1978, 1979, 1980 through 1984, and 1986, and 1987, and 1988;
(37) whether IRA is liable for the section 6651(a)(1) addition to tax for 1980;
(38) whether IRA is liable for the section 6653(a) additions to tax for 1980, and 1982 through 1988;
(39) whether IRA is liable for the section 6659(a) additions to tax for 1982 and 1983;
(40) whether IRA is liable for the section 6661 additions to tax for 1983 through 1988; and
(41) whether IRA is liable for the section 6662(a) accuracy-related penalty for 1989.

For convenience and clarity, the Court's findings of fact and opinion are set forth under each issue. The findings of fact with respect to any issue incorporate by this reference the findings of fact as found in any preceding issue.

Issue 1. Whether Payments Made By the Five in the Prudential, Travelers, and Kanter Transactions During the Years at Issue Are Properly Taxable to Kanter, Ballard, and Lisle, and, if so, whether they are liable for the fraud additions to tax and penalty with

respect to such income

FINDINGS OF FACT

The parties have filed several stipulations of fact. The facts reflected in these stipulations, with the annexed exhibits, are so found and are incorporated herein by reference.

I. Background

A. Petitioners' Residences and Principal Place of Business

At the time the petitions were filed, the principal place of business of Investment Research Associates, Ltd. (IRA), was in the State of Illinois, the Kanters' legal residence was in the State of Illinois, the Ballards' legal residence was in the State of Florida, and the Lisles' legal residence was in the State of Texas. Donna Lisle died on April 12, 1993, and Robert W. Lisle died on September 17, 1993. Their two children, Amy L. Albrecht and Thomas W. Lisle, are the coexecutors of the Estates of Robert W. Lisle and Donna M. Lisle. The estates have been substituted as parties and the two children as representatives of the estates. Amy Albrecht and Thomas Lisle were legal residents of the State of Texas at the time they were substituted as representatives of the estates of their deceased parents.

B. Kanter

Kanter is an attorney who has been engaged continuously in the practice of law in Chicago, Illinois, since about 1956. He received a J.D. degree from the University of Chicago in 1952. From 1952 to 1954, he was a teaching associate at the University of Indiana Law School. Since 1956, his law practice has been in Chicago, Illinois. His primary expertise is in Federal income and estate taxation. From 1964 to 1981, Kanter was a partner in the law firm of Levenfeld & Kanter, which later became Levenfeld, Kanter, Baskes & Lippitz. That firm was dissolved in 1981, and Kanter thereafter practiced with the firm of Kanter & Eisenberg. As of the time of trial, Kanter was of counsel with the Chicago firm of Neal, Gerber & Eisenberg.

At the time of the trial and for the prior 10 years, Kanter taught courses in estate and gift taxation and estate planning

at the University of Chicago Law School. Kanter has lectured and written extensively in the area of Federal tax law. He has also been an active participant in professional bar associations. For a number of years, Kanter has been a writer and contributor to the Journal of Taxation, a national monthly publication devoted exclusively to Federal taxation. One of the features of this publication is the Shop Talk section which he originated. At the time of trial, Kanter was a senior editor with the Journal of Taxation. Kanter is generally recognized as well known in his field. This recognition has resulted in a successful law practice, which has led to Kanter's being involved in consultation, development, and investments in a number of business fields and enterprises. For instance, Kanter has performed extensive legal work for the Pritzker family, majority owners of the Hyatt Corp., a major hotel company. Kanter also served as a director on the boards of several corporations and charitable organizations.

Petitioner Naomi R. Kanter, Kanter's wife, was not involved in any of the activities giving rise to this litigation. However, she filed joint Federal income tax returns with Kanter for the years at issue.

C. Ballard

Ballard was an employee in the real estate department of The Prudential Insurance Co. of America (Prudential) from 1948 until his retirement in 1982. During the course of his career at Prudential, Ballard was assigned to several regional offices of Prudential, including Houston and Dallas, Texas, and beginning in 1966 in the corporate headquarters of Prudential at Newark, New Jersey, and then again, for a short time, at the Houston regional office. In 1973, he was reassigned to Prudential's Newark corporate headquarters, where he remained until his retirement in early 1982. At the time he left Prudential, Ballard was a senior vice president in charge of equities and worked under Donald Knab (Knab), who was in charge of all of Prudential's real estate operations.

Ballard's work with Prudential in its real estate equity operations involved the purchase, development, management, and sale of property. Ballard supervised the staff of this department at Prudential's headquarters, as well as the real estate department staff at Prudential's regional and field offices throughout the United States. Ballard could influence the choice of builders and contractors for Prudential projects and could influence or prevent a project from going forward.

Shortly after leaving Prudential, Ballard became a general partner with Goldman Sachs, an investment firm in New York City. In November of 1988, he retired as a general partner and became a limited partner with Goldman Sachs. In his position with Prudential, Ballard met and was in contact with attorneys, developers, businessmen, and contractors involved in or affected by Prudential's real estate activities.

D. Lisle

Lisle graduated from the University of Missouri with a B.S. degree in public administration. He attended law school at the University of Missouri, graduate schools of management and business at Columbia University, and the graduate school of management at Princeton University.

Like Ballard, Lisle was employed by Prudential. Lisle worked for Prudential in real estate development and in mortgage financing from September 1950 to April 1982. Lisle headed the division responsible for lending money and buying and building real estate for Prudential. He had authority to commit any loan up to $20 million and to award construction contracts. The development aspect of his work was conducted through a subsidiary corporation of Prudential known as PIC Realty Corp. (PIC Realty). [FN7] Lisle was president of PIC Realty.

To a large extent, Lisle's career paralleled Ballard's. Like Ballard, Lisle worked in various regional offices of Prudential and ultimately was promoted to a senior executive position at Prudential's Newark corporate

headquarters. The offices of Lisle and Ballard were next door to each other, and Lisle's supervisor at Prudential was also Donald Knab. To some extent, Ballard and Lisle's duties overlapped. At the time Lisle left Prudential in 1982, he was a vice president of Prudential.

In April 1982, after leaving Prudential, Lisle began working for The Travelers Insurance Co. (Travelers), doing virtually the same kind of work he had done for Prudential. He worked for Travelers until April 1988.

Donna M. Lisle, Lisle's wife, was not involved in any of the activities giving rise to this litigation, and her estate is a party to these proceedings solely by virtue of Mrs. Lisle's having filed joint Federal income tax returns with Lisle for the years at issue.

II. The Kanter Enterprise

A. Overview

Kanter met Ballard and Lisle sometime between 1968 and 1970. The three had numerous contacts and business dealings in succeeding years.

Kanter entered into arrangements pursuant to which he would use his business and professional contacts, including his relationships with the Pritzkers, Ballard, and Lisle, to assist individuals and/or entities in obtaining business opportunities or in raising capital for business ventures. Kanter established a complex organization of corporations, partnerships, and trusts to receive, distribute, and disguise the payments from these arrangements.

Some of these arrangements involved payments from a group of individuals referred to by the parties as "the Five". The Five made payments for Ballard's and Lisle's influence in awarding contracts with Prudential (the Prudential transactions), for Lisle's influence in awarding contracts with Travelers (the Travelers transactions), and for Kanter's influence in transactions that did not involve Prudential or Travelers (the Kanter transactions). The payments most often were made to corporations controlled by Kanter and then distributed through various means to Kanter, Ballard,

and/or Lisle, their family members, or to entities established for the benefit of their families.

Most of the payments made in the Prudential transactions were paid through IRA or one of its subsidiaries. Those made in the Travelers and Kanter transactions generally were made through another corporation controlled by Kanter, The Holding Co. (Holding Co.) or one of its subsidiaries. Funds received by IRA and its subsidiaries and Holding Co. and its subsidiaries, as well as funds of other Kanter entities and associates, were commingled in accounts administered by another Kanter controlled entity, The Administration Co. (Administration Co.) (and later Principal Services Corp.).

Some distributions to Kanter, Ballard, and Lisle were characterized as commissions, consulting fees, or directors fees. Others were recorded as receivables or loans, many of which were traded or transferred between the various entities and eventually written off as uncollectible with IRA and/or Kanter taking deductions for the writeoffs. Some of the distributions that were treated as loans were made through two Kanter entities, International Films, Inc. (Int'l Films) and Harbor Exchange Lending Operation (HELO). Large portions of the payments made in the Prudential transactions eventually were distributed to three of IRA's subsidiaries; more specifically, 45 percent to Carlco, Inc. (Carlco) (controlled by Lisle), 45 percent to TMT, Inc. (TMT), (controlled by Ballard), and 10 percent to BWK, Inc. (controlled by Kanter).

An overview of the Kanter enterprise is shown by the following diagram:

TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE

B. Investment Research Associates, Inc., and Its Subsidiaries

IRA was originally incorporated in the State of Delaware on August 26, 1974, under the name of Cedilla Co. In 1979, the name of Cedilla Co. was changed to Investment Research Associates, Ltd. Reference hereinafter to IRA also refers to its

predecessor, Cedilla Co. during years prior to the name change.

1. IRA Stock

At the time of its incorporation in 1974, IRA was authorized to issue 1,000 shares of 10-cent par value common stock, 8,000 shares of $1 par value class A preferred stock, and 1,000 shares of 10-cent class B preferred stock. By 1977 IRA was also authorized to issue 1,000 shares of $5,000 par value class C preferred stock.

IRA's annual franchise reports filed with the State of Delaware from 1975 to 1988 reported that the following shares of stock were issued and outstanding:

Year	Common	Preferred	
	Class A	Class B	Class C
1975	[blank]	[blank]	[not authorized]
1976	[blank]	[blank]	[not authorized]
1977	1,000	1,000	500 [not authorized]
1978	1,000	1,000	none none
1979	none	1,000	1,000 none
1980	1,000	1,000	none none
1981	[blank]	[blank]	[blank] [blank]
1982	none	none	none none
1983	1,000	1,000	[blank] [blank]
1984	[blank]	[blank]	[blank] [blank]
1985	[blank]	[blank]	[blank] [blank]
1986	1,000	-0-	-0- -0-
1987	[blank]	[blank]	[blank] [blank]
1988	[blank]	[blank]	[blank] [blank]

IRA's end-of-year balance sheets from 1975 to 1989 indicate the following stockholder equity attributable to the preferred and common stock:

Year	Preferred	Common
1975	$1,050	$100
1976	1,050	100
1977	1,000	100
1978	1,000	100
1979	1,000	100
1980	1,000	100
1981	1,000	100
1982	1,000	100
1983	-0-	100
1984	-0-	100
1985	-0-	100
1986	-0-	100
1987	-0-	100
1988	-0-	100
1989	-0-	100

2. IRA Stockholders

IRA's 1976 return reported that no individual, partnership, corporation, estate, or trust at the end of the year owned (or was attributed ownership under section 267(c)) 50 percent or more of the corporation's total voting stock. IRA's returns reported that from 1977 through 1982, Solomon Weisgal, trustee of the Bea Ritch Trusts, owned 50 percent of IRA's voting stock, and Mildred Schott owned the remaining 50 percent of IRA's voting stock. The Bea Ritch Trusts owned 1,000 shares of common stock, and Schott owned 1,000 shares of class A preferred voting stock. IRA's returns for 1984 through 1989 indicated that no individual, partnership, corporation, estate, or trust at the end of the year owned (or was attributed ownership under section 267(c)) 50 percent or more of the corporation's total voting stock.

a. Mildred Schott and Delores Keating

Mildred Schott (Schott) worked as a legal secretary and had a real estate broker's license. She was introduced to Kanter by a mutual acquaintance. Before she obtained her broker's

license, she worked as a real estate sales person for Delores Keating (Keating).

Prior to October 28, 1975, Keating owned 1,000 shares of common stock of Cedilla Co. On October 28, 1975, Keating's 1,000 shares of common stock were exchanged for 500 shares of the class B preferred stock, and 1,000 shares of common stock were issued to the Bea Ritch Trusts. By 1978, Keating's 500 shares of class B preferred stock were redeemed by the corporation.

Schott held 1,000 shares of the class A preferred stock until 1982. She held the stock to enable IRA to hold a corporate real estate license.

b. The Bea Ritch Trusts

Twenty-five trusts known collectively as the Bea Ritch Trusts were established in 1969 and were named after Beatrice K. Ritch, Kanter's mother. Kanter's mother is the named grantor, ostensibly contributing $100 to each of the 25 trusts. Originally, when the 25 Bea Ritch Trusts were established in 1969, the beneficiaries of the trusts were Kanter, his family, and other relatives of Kanter. By about 1977, Kanter had formally renounced all of his interest as a beneficiary in the Bea Ritch Trusts. At some time, many additional trusts were added as beneficiaries to the trusts. The identities of the beneficiaries of the additional trusts are not in the record. The original individual and additional trust beneficiaries of the Bea Ritch Trusts are as follows:

Original Trust Name	Additional Beneficiaries
BWK Trust	Burton Kanter JSK 1st Trust # 5 JSK 2d Trust # 5 JSK 3d Trust # 5
Naomi Trust	Naomi Kanter JSK 3d Trust # 19 JSK 1st Trust # 20
BN Trust	Burton & Naomi JSK 1st Trust # 4 JSK 2d Trust # 4

	JSK 3d Trust # 4
Joel Trust	Burton & Joel JSK 1st Trust # 17
	Kanter JSK 2d Trust # 17
Janis Trust	Burton & Janis JSK 3d Trust # 15
	Kanter JSK 1st Trust # 16
Joshua Trust	Burton & Joshua JSK 2d Trust # 18
	Kanter JSK 3d Trust # 18
Joel Children's Trust	Burton, Naomi, JSK 3d Trust # 17 Joel & Joel's JSK 1st Trust # 18 children living from time to time
Janis Children's Trust	Burton, Naomi, JSK 2d Trust # 16 Janis & Janis JSK 3d Trust # 16 children living from time to time
Joshua Children's Trust	Burton, Naomi, JSK 1st Trust # 19 Joshua & Joshua's JSK 2d Trust # 19 children living from time to time
JL-1 Trust	Burton, Joel, JSK 3d Trust # 11 Harriet Blum & JSK 1st Trust # 12 Joel's 1st child
JL-2 Trust	Burton, Joel, JSK 2d Trust # 12 Debbie Blum & JSK 3d Trust # 12 Joel's 2d child
JL-3 Trust	Burton, Joel, JSK 1st Trust # 13 Jeff Blum & JSK 2d Trust # 13 Joel's 3d child
JA-1 Trust	Burton, Janis, JSK 1st Trust # 9 Henry Krakow & JSK 2d Trust # 9 Janis' 1st child JSK 3d Trust # 9
JA-2 Trust	Burton, Janis, JSK 1st Trust # 10 Helen Krakow & JSK 2d Trust # 10 Janis' 3d child
JA-3 Trust	Burton, Janis, JSK 1st Trust # 11 Helen Krakow & JSK 2d Trust # 11 Janis' 3d child

JS-1 Trust Burton, Joshua, JSK 3d Trust # 13
Gerald L. Kanter & JSK 1st Trust # 14
Joshua's 1st child
JS-2 Trust Burton, Joshua, JSK 2d Trust # 14
Ruth Kanter & JSK 3d Trust # 14
Joshua's 2d child
JS-3 Trust Burton, Joshua, JSK 1st Trust # 15
Joshua's 3d child JSK 2d Trust # 15
& all of the
children of Gerald L.
Kanter living from
time to time
BK Children's Burton, Naomi and JSK 1st Trust # 1
Trust all of the children JSK 2d Trust # 1
of the Grantor's JSK 3d Trust # 1
son living from
time to time
BK Descendant's Burton, Naomi and JSK 1st Trust # 2
Trust all of the JSK 2d Tr . # 2
descendants of the JSK 3d Trust # 2
of the Grantor's son
living from time to
time
BK Grandchildren's Burton, Naomi and JSK 1st Trust # 3
Trust Burton's Grand- JSK 2d Trust # 3
children living JSK 3d Trust # 3
from time to time
Lillian Trust Burton, Naomi and JSK 2d Trust # 20
Lillian Walker JSK 3d Trust # 20
J-1 Wife's Trust Burton, Joel's Wife JSK 1st Trust # 6
and the children of JSK 2d Trust # 6
Carl I. Kanter JSK 3d Trust # 6
living from time
to time
J-2 Husband's Burton, Janis' JSK 1st Trust # 7
Trust husband and the JSK 2d Trust # 7
children of JSK 3d Trust # 7

Aloysius B. and
Helen M. Osowski
J-3 Wife's Trust Burton, Joshua's JSK 1st Trust # 8
wife and Ruth & JSK 2d Trust # 8
Philip Loshin JSK 3d Trust # 8

Solomon Weisgal (Weisgal), an accountant and a longtime friend and business associate of Kanter, has been the sole named trustee of the Bea Ritch Trusts since 1969. As trustee of the Bea Ritch Trusts, Weisgal had broad power either to accumulate the Bea Ritch Trusts' income or to distribute (i.e., sprinkle) the trusts' income and assets among all or any of the trusts' beneficiaries in a manner he deemed appropriate. Weisgal did not act independently as a trustee. Rather, he acted as Kanter directed in all matters regarding the trusts.

3. IRA Officers and Directors

Prior to October 27, 1975, Keating was president and secretary of IRA. On October 27, 1975, Keating resigned and Schott was elected as president and Sharon Meyers (Meyers) as secretary by the unanimous consent of the directors (Schott, Meyers, and Patricia Grogan (Grogan)). From 1977 to 1980, the president of IRA was Schott, and the vice president was Weisgal.

Lawrence Freeman (Freeman), an attorney in Miami, Florida, was a friend and business associate of Kanter. At Kanter's request, Freeman served as IRA's president from 1980 to 1989. Although Freeman was not paid for serving as IRA's president, he and his law firm received significant legal business through referrals from Kanter. In 1989, Kanter became IRA's acting president.

From 1976 through 1980, Schott, Weisgal, and Grogan served as IRA's directors. From 1981 through 1989, Freeman served as a director. For most of those years Freeman was the sole director. Although Ballard was not listed as a director, IRA paid Ballard $12,500 as directors fees in 1981. IRA deducted $12,500 as a director fee expense on its 1981 return.

Meyers served as an officer or director of IRA at various

times. Meyers originally worked as Kanter's secretary at Kanter's law firm. By the 1970's, her duties at the law firm evolved to her being an administrative assistant to Kanter. By 1981, she was no longer an employee of the law firm. During the years at issue, Meyers also served as an officer or director of many of Kanter's other corporations.

At all times, IRA's officers and directors made decisions and performed their duties in accordance with Kanter's instructions.

4. IRA Subsidiaries

IRA owned, from time to time, controlling interests in several subsidiary corporations. These subsidiary corporations included Brickell Enterprises, Inc., Cedilla Co., Cedilla Investment Co., IRA Florida Apartments, Inc., KWJ Corp., Zeus Ventures, Carlco, TMT, and BWK, Inc. IRA also, at one point, owned a majority stock interest in Int'l Films. Carlco, TMT, and BWK, Inc., were incorporated in the State of Delaware in 1982 but remained inactive until 1983. In December of 1983, IRA acquired 1,000 shares (100 percent) of the common stock of each of Carlco, TMT, and BWK, Inc. In December 1983 and January 1984, Carlco, TMT, and BWK, Inc., each issued shares of preferred stock. Carlco preferred shares were issued to the Christie Trust established by Kanter for the benefit of Lisle's family; TMT preferred shares were issued to the Orient Trust established by Kanter for the benefit of Ballard's family; and BWK, Inc., preferred shares were issued to the BK Children's Trust, the beneficiaries of which were members of Kanter's family.

C. Holding Co.

Holding Co. was incorporated on December 8, 1976. Holding Co. owned several subsidiary corporations, including the Citra Co., Active Business Corp., HELO, LBG Properties, Inc., The Nominee Corp., Oil Investments, Ltd., Tanglewood Properties, Inc., and Zion Ventures, Inc.

Kanter, his family, and trusts established for the benefit of his family, including the Bea Ritch Trusts and the Everglades Trusts, [FN8] owned substantially all of the stock in Holding

Co.

Kanter, Weisgal, Meyers, and Linda Gallenberger (Gallenberger) most often served as directors and officers of Holding Co.

Holding Co.'s end-of-year balance sheets indicate the following stockholder equity attributable to the preferred and common stock:

Year	Common	Preferred	Paid-in
	Class A	Class B	Class C	Class D	Capital	
1979	$23	$775	$3	$50,000	--	$407,087
1980	23	775	3	50,000	1,500,000	407,087
1981	23	775	3	50,000	--	407,087

Prior to August 1981, another Kanter entity, Computer Placement Services, had a $1,729,300 loan outstanding to Holding Co. In August 1981, $1,500,000 of the loan was converted to Holding Co. class D preferred stock. In 1983, the stockholder equity of class D preferred stock was decreased by $1,499,999 and the paid-in capital was increased by the same amount.

D. Administration Co. and Principal Services: The Banking Corporations

The funds of the various Kanter entities (as well as the funds of some of Kanter's associates) were commingled in accounts held by Administration Co. and later the Principal Services Accounting Corp. (Principal Services), both of which were also controlled by Kanter.

Administration Co. was incorporated in the State of Delaware on September 21, 1981, and was authorized to do business in the State of Illinois. Administration Co.'s offices were located either at Kanter's law firm offices or in close proximity thereto. [FN9]

The sole shareholder of Administration Co. was the Pyramid Trust. Weisgal was trustee of the Pyramid Trust, and Meyers

was the sole beneficiary.
Meyers was the sole director of Administration Co. and was its president from 1981 to 1985. Gallenberger was the vice president of Administration Co. and worked under the direction of Meyers. When Meyers left Administration Co. in 1985, Kanter briefly served as acting president of Administration Co., and, thereafter, Gallenberger became Administration Co.'s president from 1985 through 1988. [FN10]
Administration Co. had several employees, mostly clerical assistants, bookkeepers, and accountants. Meyers directed the staff and employees of Administration Co. until 1985. In 1983, Administration Co. paid $143,489 in employee compensation and distributed over $500,000 as nonemployee compensation, including $400,000 to the Rainbow Trusts (Rainbow Trust Nos. 1-25).
Administration Co. administered funds that it collected from or on behalf of various Kanter entities and associates, referred to as clients. Administration Co. clients included individuals (including Kanter, Ballard, and Lisle), corporations (including IRA, Holding Co ., and their subsidiaries), partnerships, trusts, various Kanter-related entities, and members of Kanter's law firm.
Administration Co. opened a bank account in Administration Co.'s name known as the Special E Account. The Special E Account functioned generally as a checking account for its various clients. Administration Co.'s books and records reflected each client's balance in the account and also reflected deposits or withdrawals affecting that client's account.
Administration Co. also maintained at its bank a second account known as the Special Account that served more like a savings or money market account. The moneys in this account were used to buy certificates of deposit because a higher rate of return could be realized by aggregating the funds to purchase larger denomination certificates of deposit.

Funds from both the Special E Account and the Special Account were lent to Administration Co. clients. Deposits to and withdrawals from the Special E Account and the Special Account were posted to the appropriate client accounts. If a client had a negative balance in the accounts, that debit amount was recorded as a receivable owed by the client to Administration Co. Any positive balance a client had in the accounts was considered money belonging to the client.
Administration Co. issued annual tax statements and reports to its clients and the Internal Revenue Service (IRS) for the interest earned by each client on that client's funds in the Special E Account and the Special Account.
Administration Co. maintained books and records for each of its clients and, in many instances, prepared clients' tax returns. Administration Co. prepared Kanter's income tax returns for all or some of the years at issue. Administration Co. charged a fee for its services.
Administration Co. filed for bankruptcy in February 1988, and Principal Services was organized. All of Principal Services' outstanding shares of stock were initially owned by ARO Trust, of which trust Kanter was the trustee.
Principal Services took over a number of Administration Co.'s clients, including Kanter, IRA, and Holding Co. Principal Services performed services for clients similar to those provided by Administration Co. Principal Services also established two accounts similar to the Special E Account and the Special Account. During the years at issue, Principal Services made loans to Holding Co. and BWK, Inc.
In 1990, Gallenberger purchased from ARO Trust all of Principal Services's shares for $100. In October of 1993, Principal Services moved (along with all of its clients files) to Wisconsin.
E. The Other Lending Corporations
During the years at issue Kanter often used two additional entities, HELO and Int'l Films to distribute funds including distributions to Ballard and Lisle or trusts established for the benefit of their families.

1. HELO

HELO's predecessor, Harbor Investments, Inc., was incorporated on July 21, 1978, and the stated business purpose was investments. The name was changed in fiscal year ending August 31, 1980, to Harbor Exchange Lending Operation. The Active Business Corp. (Active) owned 100 percent of the voting stock of HELO. Holding Co. owned 100 percent of the stock of Active and filed consolidated returns with HELO and Active.

On August 31, 1984, all of the shares of HELO were transferred by Active to Kanter as the trustee of the ARO Trusts. At the time of the transfer, HELO's only significant assets were loan receivables totaling $2,331,326, and its liabilities included short-term loans of $2,518,589 and long-term loans of $10,557. Holding Co. also disposed of 100 percent of the voting stock of Active Corp. in 1984.

Holding Co.'s consolidated returns reported the following income, net assets, and stockholder equity with respect to HELO: [FN11]

	08/78	08/79	08/80	08/81	08/83	08/84
Income	--	--	$1,485	$4,597	--	$136
Deductions	--	($115)	(31,309)	(149,974)	--	(30)
Total	--	(115)	(29,824)	(145,377)	--	106
NOL	--	(115)	(29,939)	--	(198,135)	
Taxable	--	(29,939)	(175,316)	--	(198,029)	
Assets						
Cash	$500	131	4,294	(879,704)	$31	322
Receivables	--	--	2,871,082	4,69 1,912	2,331,326	1,320,059
Money market	--	--	718	259	--	--
Pooled funds	--	--	--	--	--	4,636
Intangibles	151	120	89	27		

Total	500	382	2,876,214	3,812,55 6	2,331,384	1,325,017
Liabilities						
Short term	--	--	322,987	849,680	2,518,589	1,522,700
Shareholder	--	--	1,255,600	10,557	--	--
Long term	--	--	1,327,100	3,127,200	10,557	
Total	--	--	2,905,687	3,987,437	2,529,146	1,522,700
Net assets	500	382	(29,473)	(174,881)	(197,762)	(197,683)
500						
Capital stock	500	500	500	500	500	
Ret. earnings	(118)	(29,973)	(175,381)	(198,262)	(198,183)	

2. Int'l Films

Int'l Films was incorporated in September 1973. Although the record does not disclose who originally owned the stock of Int'l Films, on August 31, 1984, IRA owned 71 percent of the voting stock of Int'l Films. As of August 31, 1983, Int'l Films had loans receivable of $878,227. As of August 31, 1984, Int'l Films had loans receivable of $1,050,827.

III. Transactions Involving the Five

Prior to and during the years at issue, Prudential was one of the largest holders of commercial real estate in the United States. By the late 1970's, Prudential either held or was responsible for managing an estimated $20 billion in commercial real estate properties. Prudential also developed commercial real properties and provided financing to other real estate developers for various real estate projects around the country.

As stated previously, Kanter entered into arrangements pursuant to which he would use his relationships with the Pritzkers, Ballard, and Lisle to assist individuals and/or entities in obtaining business opportunities or in raising capital for business ventures. Some of these arrangements involved payments by a group of individuals referred to by the parties as "the Five". The Five include J.D. Weaver (Weaver), Bruce Frey (Frey), William Schaffel (Schaffel),

Kenneth Schnitzer (Schnitzer), and John Eulich (Eulich).

A. The Weaver Arrangement: Hyatt Corp.'s Embarcadero Hotel Management Contract

Hyatt Corp. manages hotels in the United States, Canada, and the Caribbean. As indicated previously, members of the Pritzker family control Hyatt Corp. Kanter has represented the Pritzkers for years as their attorney.

The Houston Hyatt Hotel was co-owned by Prudential and Tenneco Corp. (Tenneco) and managed by Hyatt Corp. Weaver was an executive with Tenneco. From 1968 through 1972, Ballard and Weaver were involved in the development of the Houston Hyatt Hotel, and Ballard negotiated the hotel's management contract with Hyatt Corp.

During the early 1970's, Prudential was also a participant in a joint venture to develop and own the Embarcadero Hotel in San Francisco. The joint venture participants sought an experienced major hotel management company to operate the hotel under a long-term management contract. Del Webb (Webb), a well-known hotel operator and owner of a large hotel management company, and Intercontinental Co., another large hotel management company, were competing for the management contract. A.N. Pritzker wanted the Hyatt Corp. to obtain the management contract for the Embarcadero Hotel; the hotel would become the third or fourth Hyatt-operated hotel in the United States at which major conventions could be held.

Lisle was supervising development of the Embarcadero Hotel for Prudential and was involved in the selection of a management company to manage the hotel. Although Hyatt Corp. was about to enter into the long-term management contract to operate the Houston Hyatt Hotel owned by Prudential and Tenneco Corp., Lisle was not interested in having the Hyatt Corp. manage the Embarcadero Hotel. Pritzker offered to pay Weaver, who had worked with Ballard in developing the Houston Hyatt Hotel, a portion of the management fees if Weaver helped Hyatt Corp. obtain the management contract for the Embarcadero Hotel.

Weaver then persuaded Lisle to consider Hyatt Corp. for the Embarcadero Hotel's management contract.

Since Ballard had negotiated the Houston Hyatt Hotel's management contract, Knab (Ballard and Lisle's superior at Prudential) directed Ballard to review and evaluate the terms of the proposed management contracts to be considered for the San Francisco Embarcadero Hotel. Subsequently, representatives of the Embarcadero joint venture participants met with Webb and Pritzker to obtain bids on the Embarcadero Hotel's management contract. Ballard and Lisle, as well as other Prudential employees, represented Prudential at the meeting. For reasons not fully shown in the record, representatives of Intercontinental Co. were not present at the meeting, and Webb refused to submit a bid during the meeting because he thought he had been promised the contract. Pritzker offered to have Hyatt Corp. enter into a management contract for the Embarcadero Hotel substantially similar to the Houston Hyatt Hotel's management contract. At the meeting Hyatt Corp. submitted the only bid, and the management contract was awarded to Hyatt Corp.

Shortly after being awarded the contract, Hyatt Corp. entered into an agreement with KWJ Corp., an S corporation solely owned by Weaver. Under the written agreement dated February 25, 1971, Hyatt Corp. agreed to pay KWJ Corp. a commission generally equal to 10 percent of Hyatt Corp.'s fees under the Embarcadero Hotel management contract. The agreement acknowledged that "KWJ" was the principal factor in bringing Hyatt Corp. and the owners of the Embarcadero Hotel together and aiding in the negotiations.

Over the period from about 1972 through 1994, Prudential eventually built a total of about 10 large, major-convention-size hotels that Hyatt Corp. managed for it. During discussions about Hyatt Corp.'s obtaining the management contract on one of the first of these other hotels built after the Embarcadero Hotel, Pritzker discussed Weaver's finder's fee

with respect to the Embarcadero Hotel's management contract with Ballard and Lisle. Pritzker told Ballard and Lisle that Hyatt Corp.'s payment of this finder's fee was a one-time occurrence. Pritzker told them that no similar finder's fees would be paid with respect to future management contracts that Hyatt Corp. obtained for other Prudential hotels.

The Embarcadero Hotel opened in May 1973. In early 1975, a dispute arose between Weaver and Hyatt Corp. with regard to the commission due for 1974. A Hyatt Corp. official informed Weaver that the Embarcadero Hotel did not generate a net profit for 1974. Weaver claimed that Hyatt Corp. was entitled to $623,201 under its agreement with Prudential and that he was entitled to 10 percent of those fees. Pritzker responded that Weaver's share of the fees should bear his share of the home office expenses. By November of 1975, Weaver and Hyatt Corp. had settled the dispute.

During the period when Weaver and Hyatt were disputing the computation of Weaver's share of the management fees, Kanter and Weaver agreed that IRA would purchase the stock of KWJ Corp. In a letter to Kanter dated March 10, 1976, Weaver confirmed "our understanding regarding my granting to your client a right to purchase all of the outstanding shares of stock of KWJ Corp." for $150,000. The letter further provided that in addition to the purchase price for the KWJ Corp. stock, KWJ Corp. would continue to engage Weaver as its president and chief operating officer. In addition, Weaver was to receive 30 percent of all payments made by Hyatt Corp. under the contract with KWJ Corp. for as long as the contract was in existence, regardless of whether he performed any services for KWJ Corp.

At that time, Hyatt Corp. was in the process of becoming privately owned, and Kanter did not want the transfer of the KWJ Corp. stock to take place until after Hyatt Corp. became privately owned. Therefore, the agreement was framed as an offer to sell the stock for a period of 4 years.

On March 14, 1977, Hyatt Corp. paid KWJ Corp. $54,848 for fees earned during 1976. Sometime prior to November 1978, Hyatt Corp.'s management contract with the hotel was modified, and Hyatt Corp. wanted to revise its agreement with KWJ Corp. By letter dated November 14, 1978, Hyatt Corp. notified Weaver that, under the proposed change, KWJ Corp. would have been overpaid by $54,848 for 1976 and would be due $12,095 for 1977. By letter dated November 21, 1978, Weaver informed Kanter of the proposed changes in the Hyatt arrangement. The letter indicated that Weaver would call Kanter to discuss the proposed change. In a letter to Hyatt Corp. dated November 30, 1978, Weaver stated that the KWJ Corp. contract would not be affected by any modifications to Hyatt Corp.'s Embarcadero Hotel contract. On December 12, 1978, Hyatt Corp. paid KWJ Corp. $60,739 for 1977.

In February 1979, Hyatt Corp. had become a privately owned entity. By letter dated September 27, 1979, Kanter informed Weaver that Kanter wanted to proceed with the purchase of the KWJ Corp. stock, effective retroactively to November 1, 1978. IRA purchased 100 percent of KWJ Corp.'s outstanding shares of stock from Weaver. IRA was to pay $10,000 of the purchase price in November 1979 and the balance by August 1980.

As a result of IRA's purchase of the KWJ Corp. stock, KWJ Corp. was included as a subsidiary on IRA's 1979 consolidated return. The 1979 consolidated return reported KWJ Corp.'s 1979 gross receipts of $171,027 and payment of the 30 percent fee to Weaver of $51,308. The 1979 consolidated return reflected KWJ Corp.'s assets, liabilities, and net worth as of January 1, 1979, as follows:

Assets
Cash $40,626
Accrued income 108,521

Total assets 149,147

Liabilities
Mortgages, notes, and bonds payable 19,400
Accrued expenses 14,663

Total liabilities 34,063

Net Worth 115,084

Common Stock 1,000
Retained earning unappropriated 53,968
Previously taxed income 60,116

Total stockholder equity 115,084

The commissions paid over by Hyatt Corp. attributable to operations from 1978 through 1982 were as follows:

Operating Year	Payment Year	Payment
1978	1979	--
1979	1980	$171,027
1980	1981	128,671
1981	1982	246,717
1982	1983	245,843

Except for the $171,027 payment received in 1980 from operations of the Hyatt hotel during 1979 that it reported on its 1979 return, IRA included the payments as income on the returns for the years of payment.
Hyatt Corp. was not informed about the sale of the KWJ Corp. stock to IRA and, therefore, continued to send the payments to Weaver, who then sent the check to IRA. IRA then paid Weaver his 30 percent and deducted the payments as a commission expense.
A letter dated March 29, 1983, from Weaver to Kanter states:
Attached is the check from the Hyatt Corporation in the

amount of $245,843.00, which represents K.W.J.'s commission for the year ending December 31, 1982.
Will you please deposit and issue appropriate checks to the participants.
This represents approximately the same amount as last year, per the attached balance sheet.
By August 1983, Weaver advised IRA that he wanted to modify his arrangement with KWJ Corp. The new arrangement provided that Weaver could retire from any and all activities with respect to KWJ at any time after December 31, 1983. Weaver would continue to receive 30 percent of any amount received by KWJ Corp. from Hyatt Corp. with respect to the management contract of the Embarcadero Hotel. Weaver's 30-percent interest would pass to his estate or such other specific persons as he might designate in writing.
In December 1983, KWJ Corp. was liquidated, and its assets were distributed to IRA. On January 2, 1984, IRA's new subsidiaries BWK, Inc. (managed by Kanter), Carlco (managed by Lisle), and TMT (managed by Ballard) formed a partnership called KWJ Co. (KWJ Co. partnership). Carlco and TMT each had a 45-percent interest in the KWJ Co. partnership, and BWK had a 10-percent interest in the partnership. Hyatt Corp. was not informed about the liquidation of KWJ Corp. or the formation of the KWJ Co. partnership at the time of the liquidation and formation. Hyatt Corp. continued to send payments to Weaver until Kanter notified Hyatt Corp. sometime around 1992.
From 1984 through 1989, Hyatt Corp. paid the following commissions with respect to the Embarcadero Hotel that were reported as income of the KWJ Co. partnership:

Operating Year	Payment Year	Payment
1984	1985	$295,415
1985	1986	330,376
1986	1987	327,784

1987 1988 281,926
1988 1989 75,396
1989 1990 24,340

The KWJ Co. partnership paid Weaver his 30 percent and deducted the payment as a commission expense.
B. The Frey Arrangement: Condominium Conversions.
Bruce Frey (Frey), was a certified property manager, real estate broker, and insurance broker. Frey began working at the real estate firm of Downs, Mohl & Co. in 1965. While at Downs, Mohl & Co., Frey met Kanter. In the early 1970's, Frey formed D.M. Interstate, Inc., a real estate management company that was an S corporation. In 1975, James Wold (Wold), became a shareholder and employee of D.M. Interstate, Inc. Sometime later, Frey also formed BJF Development, Inc., a corporation that engaged in real estate development and management. Frey was the sole shareholder of BJF Development, Inc. Hereinafter, D.M. Interstate, Inc. and BJF Development, Inc., are each sometimes referred to as a Frey corporation.
In 1978 or 1979, Frey began converting rental property into condominiums. Frey or a Frey Corporation purchased rental property, refurbished it, and then sold the individual units as condominiums. Frey or a Frey corporation earned development fees for managing and supervising the renovation and conversion work on the property. A condominium project typically involved the use of a limited partnership. As a partner in the partnership, Frey or a Frey corporation would also receive profit distributions that were based upon sales of condominiums. Frey or his Corporation also earned management fees for their services in managing the condominium units following the conversion.
Frey's first condominium conversion project was called Moon Lake Village and involved an apartment building located in Hoffman Estates, Illinois. A joint venture limited partnership was formed to purchase the apartment building and convert it to condominiums. Frey was the general

partner in the partnership and there were several investors who made contributions to the partnership. A Frey corporation received development fees, profit participation, and management fees in the Moon Lake Village project. Neither Kanter nor Prudential was involved in the Moon Lake Village project.
After successfully engaging in the Moon Lake Village conversion in 1978, Frey met and consulted with Kanter to obtain tax advice in connection with that project. During their meeting or shortly thereafter, Frey and Kanter discussed Frey's need to raise capital for future condominium conversion projects. At that time, condominium conversions were occurring frequently in metropolitan areas throughout the country, and Frey was faced with having to raise capital to acquire and convert apartment building properties in which he and other competing condominium converters were interested. Although Frey generally could obtain financing from a bank for most of a condominium conversion project's cost, the bank usually required Frey and other investors to have a substantial investment in the project. Kanter said that he could help raise some of the capital Frey needed for the condominium conversion projects. In consideration for such assistance, Kanter required Frey to share the development and management fees that Frey earned from such projects. Frey agreed to pay Kanter a share of the development and management fees if Kanter caused a third party to invest money in a project. Furthermore, if Kanter invested in a conversion project, he would also share in the profit participation of the partnership.
From 1978 to 1987, a number of condominium conversion projects were undertaken by limited partnerships that Frey and the Frey corporations formed with other investors. Frey or a Frey corporation often served as the general partner in such limited partnerships. In many instances, the limited partnerships acquired an apartment complex, renovated and converted it into condominium units, and sold the

condominium units to individual purchasers.
Beginning with Frey's second condominium conversion project, entities associated with Kanter received limited partnership interests in many of Frey's condominium conversion projects. The Kanter entities that received such partnership interests included Zeus Ventures, Inc. (Zeus), a subsidiary of IRA, and Zion Ventures, Inc. (Zion), a subsidiary of Holding Co. Kanter also brought other investors into some of Frey's condominium conversion projects for which Kanter entities received a share of development and management fees. Projects in which Kanter entities received fees or interests included the Lakewood Associates project and the 535 Michigan Avenue project.
The first condominium conversion project that Frey undertook involving Prudential was a 1,000-unit townhouse apartment complex called Village of Kings Creek at Miami, Florida. About 1979, Frey approached a Prudential real estate department executive working in Prudential's Miami, Florida, regional office about purchasing the Village of Kings Creek apartment complex. The apartment complex was owned by a pension fund managed by Prudential. Frey offered to purchase the apartment complex for a cash price of about $20 million. He also advised the Prudential executive that Connecticut Mutual Life Insurance Co. would be joining Frey in purchasing the property. Prudential previously had considered selling the apartment complex, and Frey's $20 million offer for the property significantly exceeded the property's appraised market value.
The Prudential executive consulted with Ballard about Frey's offer. Ballard thought that Prudential's refusal of such offer might constitute a breach of fiduciary duty as investment manager of the pension fund. Ballard advised the executive that Prudential should accept the offer.
On January 16, 1980, the Village of Kings Creek partnership was formed for the purpose of purchasing the property from Prudential and converting it into condominiums. In 1980, the

Village of Kings Creek apartment complex was sold by Prudential to the partnership. Zeus (a subsidiary of IRA) and Zion (a subsidiary of Holding Co.) became limited partners in this limited partnership. Kanter also brought in another investor, First Illinois Enterprises (an Illinois general partnership), that invested $1.5 million in the project. The financing for the Village of Kings Creek project came from the following sources: The First National Bank of Chicago was the first mortgage lender; Connecticut Mutual Life Insurance Co. and First Illinois Enterprises were the two primary equity participants.
Under the partnership agreement, Zeus was required to make an initial contribution of $100,000 for its 6.14-percent interest in the partnership. Zion was required to make an initial contribution of $108,014 for its 6.66-percent interest in the partnership. In the event of certain circumstances, the partners agreed to make additional contributions to the partnership. The partnership agreement provided that the partnership would reimburse or credit the capital accounts of the Frey corporation, Frey, Wold, and Zion for "the advances made by them in negotiating, entering into and performing the terms and conditions of Purchase and Sale Contract and Contractual Commitments".
Following Prudential's sale of the Village of Kings Creek property, the executive in the Miami regional office who had dealt with Frey in the sale approached Frey about converting another Prudential apartment property in Florida into condominiums. Beginning with this property, Prudential participated in a number of successful condominium conversion projects with Frey. Most of these projects that Frey and Prudential undertook were joint ventures.
Frey did not have to raise much capital to engage in these joint venture projects with Prudential, because Prudential owned the apartment property to be converted and participated as co-owner in a joint venture to convert and sell the property as condominium units. Prudential would contribute the property and receive (1) all initial

condominium unit sale proceeds up to a specified amount based, in large part, on the property's appraised fair market value as a rental property, and (2) 50 percent of all other unit sale proceeds above the initial specified amount. A limited partnership received 50 percent of the proceeds above Prudential's initial specified amount of the proceeds from the sale of units. A Frey corporation was responsible for renovating and converting the property and selling the condominium units in exchange for development fees and management fees from the owners of the condominiums for managing the property after the conversion. Some of the Frey-Prudential agreements included the Calais and Chatham agreements, both dated August 1, 1981, the Valleybrook agreement dated October 1, 1981, Old Forge agreement entered into prior to October 12, 1981, and The Greens agreement entered into prior to December 30, 1981. Frey's agreement that he would share development and management fees with Kanter entities was formalized in two separate written agreements each dated October 12, 1981. One agreement was between Frey and IRA's subsidiary Zeus, and the other agreement was between Frey and Holding Co.

The written agreement with Zeus covered development fees from projects in which Prudential apartment properties were being converted. The letter agreement, from Frey to Meyers (president of Zeus), referred to Zeus' "Participation in Proceeds on Prudential Conversions" and provided:

As requested, we are writing to confirm our prior agreement regarding the participation in the amounts realized or to be realized on the condominium conversion of properties of or for The Prudential Insurance Company of America ("Prudential").

The terms of this letter agreement shall apply with respect to all conversions of Prudential properties heretofore and hereafter.

As used in this letter agreement, the term "amounts realized" includes all amounts to be received by the converter as

Developers' Fees and shares of assigned profits but excluding any management or other fees (which shall be retained by the Manager). * * *

* * *

Of the amounts received as a Developers' Fee on Prudential conversions, BJF (or its counterpart in any future conversion) shall retain 75% of the amount received in reimbursement for any costs and expenses paid or incurred by it. BJF shall retain this 75% amount without regard to the actual amount of its costs and expenses and without any need to account for the same. Of the remaining 25%, BJF SHALL RETAIN 80% and shall distribute the remaining 20% to you.

Of the amounts received as shares of assigned profits, BJF shall distribute 20% to you and retain the balance. BJF shall retain amounts under this letter agreement for itself and for distribution to its affiliates in such percentages as they have agreed.

BJF shall make all distributions to you not later than 30 days after the date of this letter or receipt from Prudential of the Developers' Fees and assigned profits (as the case may be).

Pursuant to this letter agreement, the BJF corporation paid the following amounts to Zeus during the years 1980 through 1985:

Year	Zeus
1980	$127,372
1981	105,764
1982	538,781
1983	110,125
Total	882,042
1984	103,500
1985	128,763
Total	232,263

The second letter agreement was from Frey to Kanter as president of Holding Co. and specifically excluded developers' fees from projects involving Prudential properties (covered in the Zeus agreement) but included other amounts related to projects involving Prudential. The letter agreement referred to "Participation in Condominium Conversions" and provided:

As requested, we are writing to confirm our prior agreement regarding the participation by us and our affiliates in capital contributions, profits and losses and Developers' Fees (excluding Developers' Fees in condominium conversions of properties of or for The Prudential Insurance Company of America and excluding legal, management or any other fees, which shall be retained by the recipients) in condominium conversions of properties.

The provisions of this letter agreement shall apply in the case of condominium conversions of those properties listed below and any other condominium conversions in which we agree to participate. Each of us may terminate this agreement at any time on forty-five (45) days or more prior written notice. The termination, however, shall be effective only with respect to new condominium conversions (i.e . conversions of properties not under discussion between us or otherwise in process on the last day of the forty- five (45) day period). The participation in capital contributions and profits and losses shall be as follows:

The Holding Company, a Delaware corporation, its nominees and/or affiliates--("THC") 33%

Bruce J. Frey and his nominee and/or affiliates--("BJF") 67%

The participation in Developers' Fees shall commence with respect to fees received after October 1, 1981, and shall be as follows:

Holding Co. 5%
BJF 95%

100%

As used herein, the terms capital contributions, profits and losses and Developers' Fees refer to those items allocated or allocable to us and our affiliates.

The properties presently subject to this letter agreement are those properties which we are converting as consultant to the Prudential Insurance Company of America. As you know, we are, of course, also participating as partners in various other condominium conversions (e.g. 535 N. Michigan Ave. Condominium, Lake Howell Condominium, etc.), but our agreements in those instances are subject to the terms of various limited partnership agreements.

Pursuant to this second letter agreement, the Frey corporation paid to Holding Co. $80,616 as a distribution in 1981 and $16,200 from participation in fees in 1983. Payments made in 1982 are not in the record.

On June 15, 1984, BJF Development, Ltd. (the Frey partnership), an Illinois limited partnership, was formed. Frey, Wold, and the Frey corporation were the general partners of the Frey partnership. The limited partners were TSG Holdings, Inc., FWID, Ltd., and Holding Co. Under the partnership agreement Holding Co. was entitled to distributions of 13.125 percent of available cash- flow. Generally, the purpose of the partnership was to conduct business activities related to development of condominiums and cooperatives and property management.

TSG Holdings, Inc. contributed $750,00 to the Frey partnership. Transcontinental Services Group, N.V., a Netherlands Antilles corporation and TSG Holdings, Inc.'s parent corporation, lent $1.75 million to the Frey partnership.

In addition to other assets contributed to the Frey

partnership, the remaining partners assigned their right to receive fees under other management, consulting, and/or partnership agreements, including the Village of Kings Creek, Lakewood, Calais, Chatham, Valleybrook, The Greens, and Galaxy Towers that had previously been subject to the letter agreement between Holding Co. and the Frey corporation. The partnership agreement also listed two participation agreements with "Burton J. Kanter" regarding certain condominium conversions. The agreement indicated that the two participation agreements had been canceled with respect to new condominium conversions.

A letter dated June 20, 1984, to Kanter described Holding Co.'s obligation to contribute to the capital of the partnership as follows:

With the recording of the Certificate of Limited Partnership, The Holding Company should:

a. make its cash capital contribution of $29,913.80 to the Partnership;

b. pay FWID, Ltd. ("FWID"), $86,789.57 for contributing cash equivalents to the Partnership on its behalf;

c. issue a $88,387.46 secured note to FWID for contributing other assets to the capital of the Partnership on its behalf; and

d. confirm its agreement to remit to FWID its share of Partnership distributions resulting from the Partnership's realization of the fees and profits shown on Part II of Appendix A.

The parties contributed a total of $170,936 in cash to the capital of the Partnership. See item 8 of Part 1 of Appendix A. Of this amount, The Holding Company is responsible for 17-1/2 percent or, as shown above, $29,913.80.

The parties contributed a total of $495,940.31 in cash equivalents to the Partnership. The Holding Company's share of this amount is, as noted above, 17- 1/2 percent or $86,789.54. The cash equivalents consist of the items shown as numbers 6, 7, and 9 on Part I of Appendix A. The items are:

6. October 31, 1983, Agreement with Lazard Freres & Co. $273,547.00

7. April 14, 1983, Real Estate Sale Agreement as amended with 211,082.00
Norman Rudenberg and Edna Davidson

9. Furniture, fixtures, and equipment 11,311.31

Total $495,940.31

As shown in the enclosed chart, The Holding Company's remaining obligation for capital contributions to the Partnership was $145,798 .66. Of this amount, The Holding Company satisfied $57,409.20 by the transfer to the Partnership of a 20 percent interest in the $287,046 of purchase money mortgages relating to the condominium units at 535 North Michigan Avenue. Accordingly, after satisfying its share of the cash capital contributions, The Holding Company's remaining obligation to FWID is $88,387.46.

The Holding Company now should satisfy its obligation for the cash contribution to the Partnership by transferring $29,913.80 in cash to it. The Holding Company should satisfy its obligation to FWID for the transfer of the cash equivalents by paying FWID $86,789 .54. In addition, The Holding Company should satisfy its responsibility for the balance of $88,387.46 by signing a note for this amount payable to FWID and pledging as security either third- party paper or other acceptable collateral.

The note should provide for cash payments as the Partnership realizes cash from the capital contributions to it.

I believe that you should discuss the procedures regarding the issuance of the $88,387.46 secured note with Jim Wold or, in my absence, my associate, Claire Pensyl.

The remaining item is, as noted above, for The Holding Company to confirm its agreement to remit its share of Partnership distribution to FWID. The Holding Company's agreement is to remit distributions (a) only after The Holding Company has received Partnership distributions equal to The Holding Company's original capital contribution of $262,500 and (b) then only in an amount equal to 13.125 percent of the amount realized by the Partnership from all the items shown on Part II of Appendix A. The 13.125 percent equals The Holding Company's share of all Partnership distributions under Section 3.2 of the Agreement of Limited Partnership.

In January 1985, approximately 6 months after the formation of the partnership, TSG Holdings purchased additional interests in the Frey partnership for $1,382,575, of which $241,950 was payable to Holding Co. The purchase price was paid to Holding Co. in two installments. The letter dated January 8, 1985, accompanying the first installment provided as follows:

Enclosed is FWID, Ltd. check number 113 in the amount of $66,507 .00. This check represents your allocable share of the above-mentioned transaction after reducing your loan from Bruce Frey by one-half, or $44,194.00.

The following is a brief analysis of the transaction, your allocable share and a calculation of the manner in which check number 113 was derived:

1. Gross Sales Price $1,382,575

2. Ownership Percentage of BJF Development, Ltd. (11.1895 divided 17.5
by 63.94 percent)

3. Allocable Share of Gross Sales Proceeds 241,950

4. Sales Proceeds Received to Date 632,575

5. Allocable Share of Sales Proceeds Received to Date 110,701

6. Less: One-Half of Outstanding Loan from Bruce Frey
($88,388 .00 44,194
divided by 2)
---

7. Check Number 113 $66,507

The letter dated January 24, 1985, accompanying the second installment provides as follows:

Enclosed please find check number C 1148 in the amount of $131,250.00. This check represents the second and final installment payment with regard to your sale of partnership interest in BJF Development, Ltd. to TSG Holdings.

The entire second installment payment to the selling partners was $750,000.00. Your allocable share of the transaction was 17.5 percent, thus equaling the $131,250.00.

From 1984 through 1987, the Frey partnership paid a total of $403,954 to Holding Co. ($113,827 in 1984, $256,557 in 1985, and $33,570 in 1987). Of the $113,827 paid in 1984, $98,437 was identified as a distribution and $25,391 as Holding Co.'s share of fees. Of the $256,557 paid in 1985, $197,757 was Holding Co.'s share of proceeds from the sale of the additional partnership interest to TSG Holdings, $55,950 as a distribution, and $2,850 represented participation in developers' fees.

C. The Schaffel Arrangement: Real Estate Construction and Financing

Schaffel was a mortgage broker and a real estate developer. In the summer of 1979, Kanter invited Schaffel to dinner at a New York City restaurant to discuss a business proposition. He told Schaffel that Ballard and Lisle would also be joining them for dinner. Schaffel accepted Kanter's invitation. In addition to learning more about the potential business opportunity that Kanter had mentioned, Schaffel was eager to meet and socialize with Ballard and Lisle, as he knew that

they were senior Prudential real estate executives.
During the dinner, Kanter asked whether Schaffel would be interested in arranging the financing for a casino hotel to be built in Atlantic City, New Jersey. Prudential was not involved in that project. Kanter offered to introduce Schaffel to the people who wanted to build the casino hotel provided Schaffel would agree to pay to one of Kanter's entities 50 percent of Schaffel's brokerage fee earned in the transaction. Schaffel agreed to pay the fee to an entity that held a real estate brokerage license. The casino hotel project, however, never materialized.
Although the casino hotel project fell through, Schaffel agreed to share certain finder's fees with Kanter in other projects. With Kanter's "concurrence", Schaffel negotiated a finder's fee arrangement with Benedict Torcivia (Torcivia), [FN12] the sole shareholder of Torcon, Inc. (Torcon). At the time, Torcon was probably the largest general contracting company in New Jersey. By letter agreement dated July 23, 1979, Torcivia agreed to pay Schaffel a fee for any construction projects that Schaffel helped obtain for Torcon. The agreement reached between Kanter and Schaffel as applied to Schaffel's arrangement with Torcon was set forth in a letter agreement with IRA dated August 2, 1979, as follows:
The purpose of this letter is to confirm that I will pay you fifty (50%) percent of any fees received by me with respect to construction jobs obtained for Torcon, Inc. in which I determine that you or your associates have been instrumental or helpful. My arrangement with Torcon, Inc. concluded with your concurrence that said Company will pay to me one (1%) percent based on the gross amount of the contract price of any such construction job. It is our understanding that you will receive payment ordinarily over a period of time depending on draws under the construction job. Accordingly, you will expect to receive payment only as I am paid.
It is further understood that the foregoing pertains only to

negotiated contract situations and should any bid situation arise, the amount of your participation will be negotiable.
Schaffel also entered into a finder's fee arrangement with William Walters (Walters), a real estate developer in Denver, Colorado, similar to the one with Torcivia, and agreed to share those fees with IRA.
1. Schaffel/Prudential Transactions
As a result of his introduction to Lisle and Ballard, Schaffel began doing millions of dollars' worth of business with Prudential. These business dealings included construction contracts that he helped obtain for Torcon and financing for a number of large commercial real properties being developed by Walters, as well as transactions involving others.
The first transaction Schaffel negotiated with Prudential was the sale of the IBM headquarters building in Lexington, Kentucky. The property was brought to Schaffel's attention by Transatlantic Consultants (Transatlantic), the company brokering the sale. Schaffel introduced the Transatlantic representative to Ballard. After the initial meeting with Ballard, Transatlantic dealt with Prudential's local office in Kentucky. Seven months after the initial meeting with Ballard, Prudential bought the building. Schaffel received a fee from brokering the sale of the building and paid half of the fee to IRA.
Some of the projects Schaffel assisted Torcivia in obtaining with Prudential included the Parsippany Business Campus, the Parsippany Hilton Hotel (located outside of Newark, New Jersey), the Gateway (located in Newark, New Jersey), and the Interplex Complex (located in Princeton, New Jersey).
Walters agreed to pay Schaffel a finder's fee with respect to two joint ventures that Walters helped negotiate with Prudential. Schaffel entered into separate written agreements dated October 19, 1981, with Cherry Creek Place Associates II (Prudential funding of $15.6 million) and Aurora Plaza & Conference Center, Ltd. (Prudential funding

of $17 million), with respect to the joint ventures. In each agreement, the partnership acknowledged that Prudential's participation in the venture was primarily the result of Schaffel's efforts and that Schaffel was entitled to be compensated.

From 1979 through 1983, pursuant to his arrangement with Kanter, Schaffel shared with IRA fees from these business deals with Prudential. Schaffel paid the following amounts from Prudential transactions to IRA from 1979 through 1983:

Year	Amount
1979	$100,000
1980	244,920
1981	361,525
1982	447,450
1983	30,981
Total	1,184,876

After Ballard and Lisle left Prudential, Schaffel no longer negotiated any transactions with Prudential.

2. Schaffel/Travelers Transactions

Lisle left Prudential in late 1981. He was employed by Travelers from April 1982 until April 1988. After Lisle began working for Travelers, Schaffel met with Lisle and others from Travelers. Thereafter, Schaffel began brokering substantial business dealings with Travelers on behalf of Torcon and Walters.

The first project Walters entered into with Travelers was Stanford Place II. By check dated November 9, 1983, Schaffel paid IRA $213,750 of the fee earned from Stanford Place II. After that payment, Schaffel stopped paying IRA a share of the fees earned on business deals with Travelers. Sometime during 1984, Kanter contacted Schaffel and asked why IRA was not receiving 50 percent of Schaffel's fees on Travelers transactions. Schaffel took the position that the August 2,

1979, agreement did not apply to deals with Travelers after Lisle had left Prudential. Kanter disagreed and maintained that the August 2, 1979, agreement continued to apply.

In a letter dated August 28, 1984, to Schaffel, Kanter stated:

I am bothered by your failure to respect what I would have considered the essential intent of the agreement you entered into vis-a-vis the introduction of you to Prudential and the arrangement under which you would share the benefits of that introduction in connection with real estate transactions from which you were able to earn commissions, as well as the other construction contracts won by Ben [Torcivia].

I appreciate that there may be some technical difficulty with the previous agreements as to whether they extend in the new circumstances to Travelers. However, in my view Travelers has replaced Prudential as a principal source of transactions because of the very personnel to whom you were first introduced. Accordingly, I am inclined to believe that the arrangement should have been continued.

Lisle and Schaffel discussed the dispute between Schaffel and Kanter. Lisle feared a lawsuit might result, and because such a lawsuit might cause some embarrassment for Lisle at Travelers, he urged Schaffel to settle the dispute.

Schaffel agreed to resume paying 50 percent of his fees on business deals with Travelers. Those fees, however, were paid to Holding Co. rather than IRA.

For some of the Walters projects brokered by Schaffel, Travelers entered into joint venture agreements with Walters' company pursuant to which Walters' company contributed the property and Travelers provided the financing. Travelers entered into joint ventures with Walters' company for the permanent financing of Stanford Place II (Travelers provided $15 million plus a $31.5 million loan), Cherry Creek National Bank (Travelers provided $8.25 million plus a $19.95 million loan), the Stanford Corporate Center (Travelers provided $43,612,622), and Boettcher Building (a.k.a the Boston Building) (Travelers' contribution to this project is not reflected in the record). For other

Walters projects brokered by Schaffel, Travelers provided financing without becoming a partner in the underlying joint venture. These projects included Orchard Place VIII (Travelers provided a $9 million loan), Orchard Place VII (Travelers provided a $8.5 million loan), and Cherry Creek Place III (Travelers provided a $10.8 million loan).
From 1984 through 1986, Schaffel paid a share of his fees on Walters-Travelers transactions to Holding Co. in the following amounts:

Year	Amount
1984	$600,000
1985	1,160,000
1986	1,003,500
Total	2,763,500

3. FPC Subventure Associates Partnership
On March 21, 1980, Kanter acquired an 8-percent limited partnership interest in Four Ponds Center Associates (Four Ponds), a joint venture involving Schaffel and Torcivia. On his 1980 Federal income tax return, Kanter reported his share of the partnership's losses.
The FPC Subventure Associates partnership (FPC Subventure) was formed as of January 1, 1981. The partners of FPC Subventure and their respective interests were: Lisle, 90 percent; the Everglades Trust (Roger Baskes, trustee), 9 percent; and Burton W. Kanter Revocable Trust (Kanter trustee), 1 percent. On January 1, 1981, Kanter transferred his 8-percent interest in Four Ponds to FPC Subventure, effectively transferring 90 percent of his interest in Four Ponds to Lisle in exchange for a receivable of $2,880 from Lisle.
A joint venture called One River Associates (One River) was formed as of November 16, 1981. Schaffel and Torcivia were

the general partners. Kanter held an 8-percent interest in One River. On January 1, 1982, Kanter transferred his interest in One River to FPC Subventure in exchange for a $2,000 receivable from FPC Subventure. Beginning in 1982, the 8-percent interest in One River held by Kanter was treated as held by FPC Subventure, and 90 percent of the income, loss, and distributions were allocated to Lisle.
On April 5, 1982, Four Ponds distributed $400,000 to Kanter. Kanter treated the distribution as a distribution to FPC Subventure. FPC Subventure retained $5,000 and distributed $395,000 to the partners, 90 percent to Lisle and 10 percent to the Kanter trusts. An additional $33,600 was distributed by Four Ponds to FPC Subventure through Kanter during 1982. During 1982 Lisle received total distributions of $384,840 from FPC Subventure. Kanter and Lisle reported on their tax returns their respective distributive shares of the FPC Subventures' partnership's income and losses.
D. The Schnitzer Arrangement: Sale and Repurchase of Property Management Systems Stock.
During the 1960's and 1970's, Schnitzer was a major real estate developer in the Houston, Texas, area. Schnitzer met Ballard and Lisle when they worked in Prudential's regional office in Houston, probably in the late 1960's.
Schnitzer had been involved in developing and managing high-rise office buildings through Century Development Co., Inc. (Century Development), a subsidiary of Century, Inc. (Century), Schnitzer's family holding company.
The real estate development business, however, typically was cyclical. In 1974, to diversify its operations and to secure a steady source of earnings, a subsidiary of Century acquired for $1.3 million the assets of a small real estate management company called Fletcher Emerson Co., Inc. (Fletcher Emerson). [FN13] Fletcher Emerson managed office buildings and other commercial real estate. A relatively small portion of its business included cleaning or janitorial services on some Texas commercial properties it managed. Shortly after Century's subsidiary acquired the assets of

Fletcher Emerson, the subsidiary's name was changed to Fletcher Emerson Co. and then to Property Management Systems, Inc. For convenience Property Management Systems, Inc., is hereinafter referred to as Schnitzer-PMS. Schnitzer became the chairman and chief executive officer of Schnitzer-PMS.

Originally, Schnitzer-PMS's property management business was conducted primarily in Houston and Dallas, Texas. Schnitzer-PMS usually managed office buildings and other commercial real estate owned by others under property management contracts on a month-to-month basis. Schnitzer wanted to expand the size of Schnitzer-PMS's property management business, as Schnitzer-PMS typically earned only a relatively modest profit margin on its individual property management contracts. Schnitzer felt that the only way to increase Schnitzer-PMS's profits was having a large volume of such management contracts.

Fletcher Emerson had been managing a relatively small number of Prudential's commercial real properties when Century acquired its assets in 1974. Schnitzer wanted to develop business from Prudential and American Building Maintenance Industries (AMBI). To that end, Schnitzer offered AMBI the opportunity to acquire 50 percent of the company. AMBI, however, declined the offer.

In 1974, Schnitzer approached Ballard (who Schnitzer had known for many years and previously had dealt with in developing office buildings in Houston, Texas) and offered to have Century give Prudential a 50-percent stock interest in Schnitzer-PMS. Although Prudential would not be required to pay for the 50- percent Schnitzer-PMS stock interest, Schnitzer hoped Prudential would award Schnitzer-PMS a large number of additional property management contracts. Ballard informed his superiors at Prudential of Schnitzer's offer.

Initially, Prudential was interested in Schnitzer's offer and invited Schnitzer to Prudential's Newark, New Jersey, corporate headquarters for further meetings and discussions

with Prudential's management. Schnitzer met with Prudential's senior executives and corporate headquarters staff, including Prudential's chairman, and with Knab (who headed Prudential's real estate department). Prudential was particularly interested in standardizing the reports it received on the operation of its various commercial real properties around the country. However, Prudential ultimately declined Schnitzer's offer because of the substantial number of pension plans whose real estate investment accounts Prudential managed. Prudential believed that having an ownership interest in Schnitzer-PMS might be a potential conflict of interest and might present problems under the pension laws.

Ballard introduced Schnitzer to Kanter sometime between the early and mid- 1970's. At some time prior to September 1976, Schnitzer and Kanter began discussing the sale of a stock interest in Schnitzer-PMS to Kanter. Kanter indicated that, through his business contacts, including the Pritzker family, he could obtain additional property management business for Schnitzer-PMS. Before Schnitzer made the offer to Kanter, Schnitzer had a conversation with Ballard to confirm that Kanter could bring in business for Schnitzer-PMS.

The initial proposal contemplated that Schnitzer-PMS would be recapitalized in order to provide for the issuance of two classes of stock, common and preferred. The preferred stock would be $1,000 par value per share, one vote per share, priority as to dividends, when, if, and as declared out of available earnings and profits up to a maximum of 8 percent of the par value in the year of declaration, and priority on liquidation. The common stock would be no par common stock carrying one vote per share. Kanter's client (IRA) would purchase 50 percent of the common stock for $50,000 and closing would be set for October 1, 1976.

Because of difficulties in finalizing the agreement, however, closing did not take place in 1976. In a letter dated April 12, 1977, to Melvin Dow, Kanter stated:

As you know, the president of The Cedilla Company is Mildred D. Schott and The Cedilla Company is actively engaged in certain phases of real estate activity. We are hopeful that the sooner the acquisition of * * * [Schnitzer-PMS] shares can be closed, the sooner that serious efforts can begin to create that synergism that could result in a sharply expanded business for * * * [Schnitzer-PMS] in its property management through the extensive contacts Schott maintains, the broad scope of opportunity that may be available to Solomon A. Weisgal and the opportunities that may arise in the course of my practice which involves representation of numerous very wealthy groups holding large property interests.

By letter agreement dated November 7, 1977, Kanter and Schnitzer agreed that Schnitzer-PMS would be recapitalized and reorganized as a Delaware corporation with an authorized capitalization of 250 voting preferred shares of $1,000 par value each and 108 voting common shares of $1 par value each. Each preferred share would be entitled to a cumulative preferred dividend of $80 per year, plus a special one-time dividend equal to 1/250 of the indebtedness of Schnitzer-PMS to American General Investment Corp. existing at the time the special dividend was declared. The special dividend was to be declared when the assets of the corporation available for payment of dividends equaled the remaining amount outstanding on the loan. At the time of the reorganization, $1.1 million that Century Development had borrowed to purchase Fletcher Emerson was still owing. The purpose of the special dividend was to permit Century Development to recover its initial investment. Kanter's client (IRA) had the option to purchase 51.3 shares of common stock (47.5 percent of the common stock) in Schnitzer-PMS for $150,000.

The reorganization was completed on January 31, 1978, and 51.3 shares of the common stock of Schnitzer-PMS were issued to IRA on February 14, 1978. All shares of Schnitzer-PMS (including those issued to IRA) were pledged to secure

Century Development's loan balance.

In conjunction with the sale of the Schnitzer-PMS stock to IRA, IRA and Century entered into a stock agreement. Article III of the agreement gave Century an option to purchase the Schnitzer-PMS stock upon the death of last to die of Kanter, Weisgal, and Schott. Section 3.03 of the stock agreement provided that the purchase price for IRA's shares of Schnitzer-PMS stock would be an amount equal to the sum of:

(a) Eight (8) times the average annual pretax operating income of the Corporation for the five (5) full fiscal years of the Corporation ending on or immediately preceding the Option Date or such lesser number of full years of operation of the Corporation as shall have expired from the date of this Agreement; plus

(b) The difference (but not less than zero) between (i) the book value of the assets of the Corporation used in its business of building management, consulting and cleaning and (ii) the lesser of Three Hundred Thousand Dollars ($300,000) or one and one-half (1-1/2) times the Corporation's average receipts for one (1) month, computed for the twelve (12) month period immediately preceding the Option Date; plus

(C) The fair market value of any other assets of the Corporation.

The computation of operating income in Subsection (a) hereof shall be computed solely with reference to the Corporation's business of building management, consulting and cleaning. The computation of the purchase price shall be made by the certified public accountants regularly retained by the Corporation.

By late 1977, Schnitzer-PMS's property management business had increased substantially. Although Prudential had declined Schnitzer's offer to give Prudential an interest in Schnitzer-PMS, Prudential became Schnitzer-PMS's biggest customer. Pursuant to Schnitzer's discussions with Prudential's management and corporate headquarters staff

in 1974, Schnitzer-PMS standardized its reports on the Prudential commercial real properties that Schnitzer-PMS managed. By 1977, Schnitzer-PMS had expanded its property management operations to other cities around the country, including Atlanta, Georgia, Los Angeles and San Francisco, California, Newark, New Jersey, and Portland, Oregon.
Schnitzer-PMS year-end balance sheets and profit/loss statements for 1976 through 1978 showed the following:

Assets	1976	1977	1978
Current	$529,225	$527,025	$690,257
Property	97,913	127,645	133,970
Other	8,142	36,542	137,459
Total	635,280	691,212	961,686
Liabilities			
Current	287,829	156,947	237,681
Long-term	6,515	21,647	33,935
Stockholder equity			
Common	1,000	1,000	108
Preferred	n/a	n/a	250,000
Contributed capital	200,000	200,000	n/a
Retained earnings	139,936	311,618	439,962
Total	635,280	691,212	961,686
Earnings			
Revenues			
Property management	1,044,173	1,448,101	--
Cleaning	2,343,512	2,811,034	--
Other	39,411	41,352	--
Total	3,427,096	4,300,487	5,977,383
Costs & expenses			

Property management	255,824	266,794	4,064,014
Cleaning	1,986,343	2,483,019	
General	864,715	1,095,499	1,078,503
Interest	2,599	4,117	3,037
Total	3,109,481	3,849,429	5,145,555
Pretax earnings	317,615	451,058	831,828
Tax allocation	143,163	155,527	--
Net earnings	174,452	295,531	--

By March 1979, Schnitzer had decided that Schnitzer-PMS should have received more opportunities for new business from Kanter and his associates and informed Kanter that he wanted to repurchase the stock held by IRA. Kanter and Schnitzer decided that one party would set a price at which that party was willing to either sell its stock to the other or buy the other's stock. By letter dated July 17, 1979, Kanter informed Schnitzer that IRA would sell its stock in Schnitzer-PMS or purchase Century Development Corp.'s stock in Schnitzer-PMS for $3.1 million. Schnitzer agreed to buy back IRA's stock for $3.1 million. On November 30, 1979, Century repurchased the 47.5-percent owned by IRA in July 1979, for $3.1 million, payable over a 10-year period with interest. At the time of the repurchase, approximately $700,000 remained outstanding on the loan from the original purchase of the Fletcher Emerson assets.
Schnitzer-PMS balance sheets and profit/loss statements for 6 months ending June 30, 1978 and June 30, 1979 showed the following:

	6/30/78	6/30/79
Assets		
Cash	$124,632.16	$284,760.00

Life insurance 41,968.71 96,144.81
Accounts receivable 555,308.63 496,200.83
Supplies 3,450.04 14,614.58
Prepaid expenses 13,877.99 45,007.01
Transportation equipment 14,101.56 17,268.74
Other equipment 116,190.70 130,547.74
---------- ----------
Total 869,529.79 1,084,543.71

Liabilities

Accounts payable 6,569.23 --
Accrued payroll expense 97,763.69 134,094.52
Other accrued expenses 109,892.85 121,486.51
---------- ----------
Total 214,225.77 255,581.03

Stockholder's equity

Capital stock 250,108.00 250,108.00
Retained earnings 384,885.60 1,198,788.79
Funds to CDC (431,036.94) (955,412.90)
1977 net income 451,347.36 n/a
1978 net income n/a 335,478.79
---------- ----------
Total owner's equity 655,304.02 828,962.68

Total liabilities & equity 869,529.79 1,084,543.71

Profit/Loss (6 months) 2,916,478.65 3,650,217.86
Gross income 1,824,034.25 2,485,250.27
---------- ----------
Operating expenses 1,092,444.40 1,164,967.59
Operating income 542,291.04 740,191.69
---------- ----------
Overhead expense 550,153.36 424,775.90

Income before acquisition 98,806.00 89,178.98
---------- ----------
Acquisition expense 451,347.36 335,596.92
Net income

Around the end of 1979 or early 1980, Schnitzer discussed the sale of Schnitzer-PMS to Minneapolis Honeywell for a price between $12 million and $13 million. Honeywell, however, decided not to purchase Schnitzer-PMS.
In 1989, IRA accepted a reduced final payment for early payment of the balance due on the sale of the stock.
IRA received the following payments of principal and interest and reported the following gain on the installment sale of the Schnitzer-PMS stock:

Year Payment Principal Interest Gain
------ -------- -------- -------- --------
1979 $150,000 $150,000 -- $142,740
1980 533,425 211,468 $321,957 201,233
1981 534,696 309,308 225,388 294,338
1982 361,692 172,441 189,251 164,094
1983 361,692 186,655 175,037 177,621
1984 361,692 202,042 159,650 192,263
1985 361,692 218,696 142,996 208,111
1986 361,692 236,724 124,968 225,266
1987 361,692 256,217 105,475 243,816
1988 361,692 277,360 84,332 263,936
1989 840,423 822,841 17,582 783,016
-------- -------- -------- --------
Total 4,590,388 3,043,752 1,546,636 2,896,434

E. The Eulich Arrangement: Essex Hotel Management Co.
1. Eulich's Background
For many years, Eulich had been a real estate developer of office buildings, shopping malls, and warehouses in Houston and Dallas, Texas. Eulich had known Ballard and Lisle since at least 1965. Eulich dealt with Ballard and Lisle

in connection with Prudential's financing his real estate development work, when Ballard and Lisle worked in Prudential's Houston regional office. [FN14] Eulich was also a close personal friend of A.N. Pritzker. Eulich met Kanter through Pritzker in the late 1960's or early 1970's. Kanter and Eulich had many business dealings with each other. Kanter helped raise capital for some of Eulich's business ventures. Eulich's real estate development activities were primarily conducted through Vantage, Inc., a corporation that he owned. In 1968, Eulich acquired Rodeway Inns, a company that owned a small chain of garden court motels. Over the years, Rodeway Inns increased the number of its motels. Rodeway Inns and Eulich obtained financing from Prudential for the acquisition of many of the additional motels. From 1968 through about 1973, Eulich dealt with Ballard in securing the financing from Prudential for Rodeway Inns.

In about 1974, Eulich and Prudential became dissatisfied with the performance of the hotel management company that was managing and operating 16 Rodeway Inns motels that had been financed by Prudential. Eulich decided to establish his own hotel management company, Motor Hotel Management, Inc. (Eulich-Management), to operate the motels. Eulich-Management was incorporated on January 1, 1975.

Eulich asked Robert James (James) who had substantial hotel management experience, to serve as Eulich-Management's president and to manage Eulich- Management's day-to-day operations. Eulich-Management's three shareholders eventually included Eulich (who was the majority shareholder), James, and another longtime business associate of Eulich.

By the end of 1975, Eulich-Management had 17 management contracts that were part of the joint venture in which Prudential was the lender and Eulich's company Vantage, Inc., was the developer. By the late 1970's, Eulich-Management had a good reputation in providing hotel

management services. Prudential's real estate department staff generally was satisfied with Eulich-Management's management of a number of hotel properties in which Prudential was involved. By about the early 1980's, Eulich-Management managed hotel properties nationwide in about 20 to 25 States. At that time, however, Eulich-Management did not manage large hotels.

2. Prudential's Gateway Hotel

In about 1976, Ballard decided that Prudential's real estate department needed to hire an individual possessing substantial expertise in hotels and hotel operations. Allen Ostroff (Ostroff) had worked for a number of years for Hilton Hotels as a hotel manager and executive. Ballard hired Ostroff to serve as Prudential's in-house consultant on hotels and hotel operations.

When Ostroff began working for Prudential, the real estate department staff in Prudential's regional offices negotiated hotel management contracts for Prudential's hotel properties on an ad hoc basis. By 1979, Ostroff had devised a model hotel management contract that Prudential's real estate department staff could use in negotiating such management contracts. Ostroff also worked on various hotel projects with Knab, Ballard, and Lisle.

One of Ostroff's first assignments at Prudential was to improve the operating condition of the Gateway Hotel located a few blocks from Prudential's corporate headquarters in Newark, New Jersey. Prudential had recently acquired the Gateway Hotel through foreclosure, and the hotel was in shabby condition. Moreover, Prudential wanted to upgrade the hotel because Prudential executives and individuals transacting business at Prudential's headquarters office frequently stayed at the hotel.

Ostroff first obtained a Hilton franchise for the Gateway Hotel. [FN15] Ostroff next hired a new hotel management company to take over the Gateway Hotel's management and operation. The new management company was owned by Stanley Cox (Cox), an experienced hotel manager Ostroff

had known during Ostroff's prior employment with Hilton Hotels. At some point, Cox assigned John Connolly (Connolly) to be the Gateway Hotel's on-site manager. Ostroff was extremely successful in turning around and substantially improving the Gateway Hotel's operating condition. Prudential executives made significant use of the hotel facilities for meetings and entertainment and were very pleased with the service that they and their guests received at the hotel.

Cox did not spend much of his own time in actually running the Gateway Hotel. Over the years, he had delegated more and more duties in the hotel's operation to Connolly. Connolly frequently interacted with Prudential executives, including Ballard and Lisle. Sometime in 1978 or 1979, Connolly met Kanter at the Gateway Hotel.

In 1981, Connolly informed Ostroff that he was considering leaving his position as on-site manager of the Gateway Hotel, because he felt he was not being adequately compensated for his services. Ostroff attempted unsuccessfully to have Cox increase Connolly's pay. Ostroff and his superiors at Prudential, including Ballard, decided to terminate Prudential's management contract with Cox and to award the management contract to Connolly.

Ostroff told Connolly that Prudential wanted him to manage the Gateway Hotel. Ostroff informed Connolly that he would have to establish a management company of his own and that all hotel employees would have to be employees of Connolly's hotel management company. [FN16] Establishing such a hotel management company, however, presented a problem for Connolly. The management company would be required, among other things, to employ a financial manager and an accounting staff to prepare and issue the financial reports required by Prudential on the Gateway Hotel's operations. The full-time employment of such personnel to perform these and other required services could well be uneconomical, since Connolly's company would be managing only one or two hotels.

Ballard introduced Connolly to Eulich. Eulich also knew Kanter from certain prior business ventures in which Kanter had helped raise capital. Kanter and Eulich were aware Connolly would need assistance for his hotel management company. Eulich also wanted Eulich-Management's business to include the management of a number of large hotels. He believed that Kanter's business contacts, including contacts with the Pritzker family, could be beneficial to Eulich-Management.

Eulich, Kanter, and Connolly decided to organize several entities to further their objectives. A hotel management company called Gateway Hotel Management Corp. (Gateway Corp.) was incorporated in 1981. Another corporation, Essex Hotel Management Co. (Essex Corp.), was also formed.

A letter from Eulich to Connolly dated October 16, 1981, indicated that Eulich provided $10,000 for the initial capitalization of Gateway Corp. The letter also indicated that initially Essex Corp. owned 80 shares (80 percent) of the Gateway Corp. stock, that Connolly owned 20 shares (20 percent), and that Connolly had an option to purchase Essex Corp.'s 80 shares. [FN17]

By March 2, 1982, however, Connolly owned 100 shares (100 percent) of the Gateway Corp. stock. A stock option agreement "made and entered into" September 18, 1981, but "executed as of" March 2, 1982, recites that Connolly owned 100 shares of $1 par value common stock of Gateway Corp. Under the stock option agreement, Connolly granted Essex Corp. a 10-year option to purchase 80 shares of the common stock of Gateway Corp. for $100 per share. [FN18] In consideration for the option, Essex Corp. agreed to pay Connolly $1,000 per year for the term of the option.

Eulich, Kanter, and Connolly also formed a partnership called Essex Hotel Management Co. (the Essex partnership or Essex), which was organized effective January 1, 1982. The partners of Essex and their partnership interests were as follows:

Partner	Partnership Interest
Eulich-Management	47.500
IRA	26.125
Holding Co.	21.375
Connolly	5.000

Although the Essex partnership agreement required its partners to contribute any capital needed to operate the partnership, very little, if any, actual capital contributions were ever required from them. The Essex partnership had no office, equipment, or employees.

In late 1981, Gateway Corp. entered into a management contract with Prudential to operate the Gateway Hotel and entered into a second management contract effective February 1, 1982, to operate another Hilton-franchised hotel that Prudential owned at Midland, Texas (the Midland Hotel). [FN19]

The Essex partnership entered into "Representation and Marketing" agreements with Eulich-Management and Gateway Corp., also effective January 1, 1982. [FN20] At the time, Eulich-Management managed the Allentown Hilton and the Madison Hotel. Although both were owned by third parties, Prudential had helped finance the construction of the two hotels. Essex's agreement with Eulich- Management (the Eulich-Management/Essex agreement) required Eulich-Management to pay to Essex 30 percent of its management fees from the operation of the Madison Hotel and 43 percent of the fees from the operation of the Allentown Hilton. The agreement with Gateway Corp. (the Gateway Corp./Essex agreement) required Gateway Corp. to pay to Essex 75 percent of Gateway Corp.'s management fees from the operations of the Gateway Hotel and the Midland Hotel. Employees of Eulich-Management performed record-keeping and reporting services for Gateway Corp. A number of Eulich-Management's personnel were instructed to do

whatever they could to help Connolly with Gateway Corp.'s operations. For instance, Eulich-Management employees helped perform the financial and accounting services that Gateway Corp. required in connection with its Gateway and Midland hotel management contracts. In yet another instance, a Eulich- Management employee helped Connolly with union negotiations. Also, after Prudential awarded the Midland, Texas, hotel's management contract to Gateway Corp., Eulich-Management's employees helped Connolly find an on-site manager for that hotel. Eulich-Management did not charge Gateway Corp. for these services. IRA and Holding Co., in contrast to Eulich-Management, provided no services to Gateway Corp.

The Essex partners agreed that Gateway Corp. and Eulich-Management generally would pay the same fees to the Essex partnership. The partnership's specified percentage of fees under each consulting and fee participation agreement could easily be adjusted and modified, as each consulting and participation agreement was cancelable by a 30- to 90-day notice. As a result, if a significant change occurred with respect to the compensation that Gateway Corp. or Eulich-Management received under a particular hotel management contract, an offsetting change then could be effectuated in the other consulting and fee participation agreements Gateway Corp. and Eulich Management had with Essex.

In late 1983, Eulich-Management received a hotel management contract for Prudential's Hilton-franchised Twin Sixties Hotel at Dallas, Texas. A new Eulich-Management/Essex agreement was made effective January 1, 1984, whereby Eulich-Management agreed to pay to Essex 70 percent of the fees from the Madison Hotel, 57 percent of the fees from Allentown Hilton, and 57 percent of the fees from Twin Sixties. [FN21]

Effective January 1, 1986, a new Gateway Corp./Essex agreement reduced Essex's share of Gateway Corp.'s fees from the operations of the Gateway Hotel and the Midland Hotel from 75 percent to 40 percent.

Although Eulich-Management was sold by Eulich to an unrelated company called Aircoa in 1986, Eulich-Management continued to participate as a partner in Essex until about 1990.
In early 1990, Gateway Corp. lost the management contracts on the Gateway and Midland hotels and ceased operating. The Essex partnership terminated by 1991.
During the years 1982 through 1988, Essex reported the following amounts as received and/or accrued [FN22] commission fee payments from Gateway Corp. and Eulich-Management:

Year	Gateway	Eulich-Mgt.
1982	$234,170	$104,121
1983	222,557	235,718
1984	268,663	242,116
1985	225,487	230,847
1986	68,000	123,089
1987	172,963	388,632
1988	142,761	238,889
Total	1,334,601	1,563,412

For the 1989 taxable year, Essex reported $293,261 in total income from consulting fees from Eulich-Management and Gateway Corp.
For the taxable years 1982 through 1989, Essex made distributions to IRA, Holding Co., Connolly, and Eulich-Management in the following amounts:

Year	IRA	Holding	Connolly	Eulich-Mgt.
1982	$86,212	$70,538	$16,500	$156,750
1983	78,375	64,125	15,000	142,500
1984	133,238	109,013	25,499	242,250
1985	120,175	98,325	23,000	218,500

1986	80,465	65,835	15,400	146,300
1987	120,698	98,752	23,100	219,450
1988	117,562	96,118	22,500	213,750
1989	51,727	42,322	9,900	94,051
Total	788,452	645,028	150,899	1,433,551

The distributions to all partners from 1982 through 1989 totaled $3,017,930.
The following diagram illustrates the Essex arrangement:
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
F. Diagram: Summary of Payments From the Five 1977 Through 1989
The following diagram shows the money paid by the Five to IRA, Zeus, KWJ Corp. and Holding Co. from 1977 through 1989:
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
Most of the payments made by the Five were attributable to Ballard's and Lisle's influence in awarding contracts with Prudential (the Prudential transactions), some were attributable to Lisle's influence in awarding contracts with Travelers (the Travelers transactions), and some were attributable to Kanter's influence in transactions that did not necessarily involve Prudential or Travelers (the Kanter transactions).
G. Changes in IRA and Subsidiaries Corporate Structure From 1974 Through 1988
IRA's predecessor, Cedilla Co., was incorporated in 1974. Keating acquired 1,000 shares of the common stock, and Schott acquired 1,000 shares of its preferred class A stock. In 1975, Weaver agreed to sell KWJ Corp. to Kanter's "client". In 1975, Keating's common stock was exchanged for 500 shares of class B preferred stock, and Weisgal as trustee of the Bea Ritch trusts acquired 1,000 shares of the common stock. The Cedilla Co's.1975 balance sheet at the end of 1975 reflected

the following:

Assets
Cash $564
Loans receivable 21,100
Prepaid expenses 89

Total 21,753
Liabilities 5,000

Net assets 16,753

Capital stock
Preferred 1,050
Common 100
Capital surplus 50
Retained earnings 15,553

The following series of diagrams illustrates the changes in the IRA organizations during the years at issue to accommodate the various transactions.
1976-77
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
Cedilla Co. acquired Cedilla Investment Co. (engaged in equipment leasing transactions) in December 1976. During 1976 Kanter negotiated IRA's purchase of KWJ Corp. from Weaver and began discussing the purchase of Schnitzer-PMS from Schnitzer. In 1977 Keating's preferred stock was redeemed.
IRA's consolidated returns for 1976 and 1977 reported consolidated net losses [FN23] of $7,954 in 1976 and $271,394 in 1977, a net loss for Cedilla Investment Co. of $174,003 in 1976 and $345,950 in 1977, and reflected the following income and end-of-year balance sheets with respect to IRA (unconsolidated):

	1976	1977
Income		
Gross receipts	$640,000	$112,982
Dividends	--	9,217
Interest	9,525	9,409
Partnership	(260,934)	5,214
Total	388,591	136,822
Deductions		
Compensation/officers	--	19,300
Salaries/wages	--	986
Commissions	213,333	12,000
Other	9,209	22,866
Total	222,542	55,152
Net Income	166,049	81,670
Special deductions		(7,114)
Taxable Income	166,049	74,556
Assets		
Cash	301,401	134,270
Loans receivable	40,000	370,500
Securities		
Marketable	15,663	290,213
Non-marketable	--	65,000
Investment in sub.	15,000	15,000
Investment in pship	(185,834)	(180,620)
Cedilla trust	--	5,000
Other	361	2,213
Total	186,591	701,576
Liabilities		
Payables	--	2,000
Short term	--	65,000

Long term -- 370,000
Other 6,900 3,182
--------- ---------
Total 6,900 440,182
Net assets 179,691 261,394
Capital stock
Preferred 1,050 1,000
Common 100 100
Capital surplus 50
Retained earnings 178,491 260,344
Cost of treasury stock -- (50)

1978
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
In January 1978, IRA purchased the Schnitzer PMS stock. In 1978, Cedilla Co. changed its name to Investment Research Associates, Ltd. (IRA). In April 1978, IRA acquired 1,000 shares (100 percent) of the voting stock of Arba Investments, Inc., and changed Arba's name to Cedilla Co.
IRA's consolidated return for 1978 reported consolidated net losses of $18,673 and a net loss for Cedilla Investment Co. of $605,992 and reflects the following income and end-of-year balance sheets with respect to IRA and Cedilla Co. (unconsolidated):

IRA Cedilla Co.
--------- ---------
Income
Gross receipts $777,499 $10,697
Dividends 20,572 --
Interest 38,885 18
Capital gain 69,715 --
Partnership 4,829 --
--------- ---------
Total 911,500 10,715
Deductions

Compensation--officers 15,000 7,500
Salaries/wages 5,051 4,287
Consulting Fees 51,900 --
Commissions 207,237 --
Other 18,565 8,446
--------- ---------
Total 297,753 20,233
Net income 613,747 (9,518)
Special deductions (16,910) --
--------- ---------
Taxable income 596,837 (9,518)

Assets
Cash 28,600 70,996
Loans
Stockholders 287,900 --
Others 734,350 6,385
Securities
Marketable 318,197 --
Nonmarketable 215,000 --
Investment in sub. 34,024 --
Investment in pship. (180,703) --
Cedilla trust 4,511 --
Other 1,051 2,060
--------- ---------
Total 1,442,930 79,441
Liabilities
Payables 70,000
Short term 197,575 --
Long term 370,000 --
Other 1,211 555
--------- ---------
Total 568,786 70,555
Net assets 874,144 8,886
Capital stock
Preferred 1,000 --
Common 100 1,000

Capital surplus 18,024
Retained earnings 873,094 (10,138)
Cost of treasury stock (50)

1979
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
Although IRA acquired 100 shares (100 percent) of KWJ Corp. in November 1978, IRA first included KWJ Corp. on its 1979 consolidated return. [FN24] During 1979, IRA sold its Schnitzer-PMS stock back to Century Development. Schaffel's payments to IRA began in 1979. Frey's arrangement began in 1979 and, in December 1979, IRA acquired 1,000 shares of Zeus Ventures, Inc. (Zeus).
IRA's consolidated return for 1979 reported a consolidated net loss of $20,728, a net loss for Cedilla Investment Co. of $320,425, and net taxable income from KWJ Corp. of $119,646 and reflects the following income and end-of- year balance sheets with respect to IRA and Cedilla Co. (unconsolidated):

IRA Cedilla Co.
--- ---
Income
Gross receipts $73,280 $101,274
Dividends 3,125 --
Interest 112,804 1,038
Gross rents 225 --
Capital gain 141,519 --
Partnership 1,157,861 --
Management fees -- 2,750
Consulting fees 100,000
--- ---
Total 1,588,814 105,062
Deductions
Compensation--officers -- 26,800
Salaries/wages -- 4,100

Depreciation 638,550 --
Consulting fees 125,000 --
Commissions 209,440 --
Other 60,911 19,470
--- ---
Total 1,033,901 50,370
Net income 554,913 54,692
Special deductions (2,055) --
--- ---
Taxable income 542,858 54,692

Assets
Cash 962,964 11,806
Loans
Stockholders 1,200 --
Others 3,725,675 21,885
Treasury bills -- 24,308
Securities -- --
Marketable 177,951 --
Nonmarketable 65,000 --
Investment in sub. 234,024 --
Investment in pship. 130,907 1,800
Depreciable assets 5,108,573 --
Less accumulated dep. (638,550) --
Cedilla trust 4,511 --
Deferred expenses 91,640 --
Other 1,029 2,060
--- ---
Total 9,864,924 61,859
Liabilities
Payables
Short term 309,795 --
Long term 5,319,924 --
Deferred income 2,807,260 --

Total 8,436,979 --
Net assets 1,427,945 61,859

Capital stock
Preferred 1,000 --
Common 100 1,000
Capital surplus -- 18,024
Retained earnings 1,426,895 42,835
Cost of treasury stock (50) --

1980
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
In January 1980, IRA acquired 1,000 shares (100 percent) of Brickell Enterprises, Inc. (Brickell).
IRA's consolidated return for 1980 reported consolidated taxable income of $65,094, a net loss for Cedilla Investment Co. of $145,887, net taxable income for Zeus of $118,269, a net loss for KWJ Corp. of $2,620, and net taxable income from Brickell of $90,225 and reflects the following income and end-of- year balance sheets with respect to IRA and Cedilla Co. (unconsolidated):

IRA Cedilla Co.
--- ---
Income
Dividends $15,467 --
Interest 578,031 $2,373
Gross rents 581,180 300
Capital gain 217,981 --
Partnerships 1,448,542 --
Commissions & fees 244,920 38,311
--- ---
Total 3,086,121 40,984
Deductions
Compensation--officers -- 19,800
Salaries/wages -- 6,918
Interest 916,507 --
Depreciation 2,115,376 2,294
Commissions/fees -- --

Other 14,226 33,705
--- ---
Total 3,046,109 62,717
Net income 40,012 (21,733)
Special deductions (13,147) --
--- ---
Taxable income 26,865 (21,733)

Assets
Cash 1,399,085 1,510
Trade receivables 703 --
Loans
Stockholders 1,200 --
Others 1,896,320 15,885
Installment receivable 2,738,532 --
Securities
Marketable 411,481 --
Nonmarketable 348,024 --
Investment in sub. -- --
Investment in pship. 326,072 --
Depreciable assets 12,468,476 22,937
Less accumulated dep. (2,753,926) (2,294)
Cedilla trust 4,511 --
Deferred expenses 91,640 --
Other 1,325 2,060
--- ---
Total 16,933,443 40,098
Liabilities
Payables 118,756 --
Short term 606,000 --
Long term 12,258,949 --
Deferred gain 2,606,029 --
Other 2,869 --

Total 15,592,603 --
Net assets 1,340,840 40,098
Capital stock

Preferred 1,000 --
Common 100 1,000
Capital surplus 18,024
Retained earnings 1,339,740 21,074

1981-82
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
During 1981, Essex Corp. and Gateway Corp. were organized. In November 1981, IRA acquired 1,000 shares of IRA Florida Apartments, Inc. (IRA Flor. Apts.). During 1982, the Essex partnership was organized. During 1982, Ballard and Lisle retired from Prudential; Lisle began employment with Travelers, and Ballard began employment with Goldman-Sachs.
IRA's consolidated returns for 1981 and 1982 reported consolidated net losses of $615,852 and $121,501, respectively, which included a net loss of $25,057 in 1981 and net taxable income of $72,407 for Cedilla Investment Co., net income of $107,887 in 1981 and $448,691 in 1982 for Zeus, net income of $91,118 in 1981 and $155,842 in 1982 for KWJ Corp., net income of $5,954 in 1981 and a net loss of $19,184 in 1982 from Brickell, and net losses of $6,568 in 1982 from IRA Florida Apts. and reflects the following income and end-of-year balance sheets with respect to IRA and Cedilla Co. (unconsolidated):

1981		1982	
IRA	Cedilla Co.	IRA	Cedilla Co.
Income			
Dividends	$2,306	--	$333,611	--
Interest	673,674	1,747	354,531	7,587
Gross rents	2,484,330	8,550	2,437,715	4,828
Capital gain	304,883	--	--	--
Partnerships	725,964	--	(483,219)	--

Commissions	205,275	62,585	325,000	112,958
Parking income	--	823	--	--
Management fees	--	2,375	5,832	--
Other fees	156,250	--	447,450	--
Miscellaneous	91	--	1,514	478
Total	4,552,773	76,080	3,422,434	125,851
Deductions				
Compensation--officers	--	26,300	--	--
Directors fees	12,500	--	--	--
Salaries/wages	9,969	9,361	26,079	9,231
Bad debts	395,600	--	162,200	--
Interest	2,164,579	--	1,872,881	32
Depreciation	2,561,361	5,047	1,610,457	5,047
Consulting fees	--	--	29,000	--
Commissions	115,400	--	--	66,776
Other	85,284	30,678	58,580	34,764
Total	5,344,693	71,386	3,759,197	115,850
Net Income	(791,920)	4,694	(336,763)	10,001
NOL	--	--	(793,880)	--
Special deductions	(1,960)	--	(322,569)	--
Taxable income	(793,880)	4,694	(1,453,212)	10,001
Assets				
Cash	28,671	1,885	57,110	104
Money market	107,379	8,684	43,885	14,065
Receivables				
Notes & accounts	2,429,224	--	2,256,783	--
Rents	3,570	--	--	--
Loans				
Stockholders	366,350	--	340,930	--
Others	3,066,284	26,860	3,002,131	37,600
Securities				
Short term	1,030,000	--	1,460,000	--
Marketable	405,293	--	492,663	--

Nonmarketable 200,700 -- 312,700 --
Investment in sub. 236,024 -- 268,924 --
Investment in pship. 2,607,473 -- 2,149,204 --
Depreciable assets 12,478,152 24,550 10,270,651 24,550
Less accumulated dep. (5,315,286) (7,341) (6,000,765) (12,388)
Other -- 447 1,190 1,380
---------- ---------- ---------- ----------
Total 17,643,834 55,085 14,655,406 65,311
Liabilities
Short term notes 585,000 9,600 1,038,099 9,600
Long term notes 13,754,966 -- 11,259,516 --
Loan from stockholder 262,400 -- 2,400 --
Deferred gain 2,311,689 -- 2,147,594 --
Other -- 693 914 981
---------- ---------- ---------- ----------
Total 16,914,055 10,293 14,448,523 10,581
Net assets 729,779 44,792 206,883 54,730
Capital stock
Preferred 1,000 -- 1,000 --
Common 100 1,000 100 1,000
Capital surplus -- 18,024 -- 18,024
Retained earnings 728,679 25,768 205,783 35,706

1983
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
IRA reported that it liquidated Brickell, IRA Florida Apts., and KWJ Corp. under section 332 during 1983. In December 1983, IRA acquired 1,000 shares (100 percent) of the common stock of Carlco, TMT, and BWK, Inc.
IRA's 1983 consolidated return and adjusting journal entries show that Schott's shares of IRA preferred stock were redeemed in 1983 in exchange for IRA's 1,000 shares of Cedilla Co. common stock. IRA reported that its shares of Cedilla Co. were redeemed for $1,000 in April 1983 and reported a long-term capital loss of $18,024 on the sale. IRA's consolidated income also included a $35,000 net operating

loss from Cedilla Co. Cedilla Co. had no income and claimed a deduction of $35,000 for commission expenses. Cedilla Co.'s 1983 adjusting journal entry indicates that the $35,000 due to Schott was paid by offsetting amounts owed by Schott to Cedilla Co.
IRA's consolidated return for 1983 reported a consolidated net loss of $425,538, net income of $140,065 for Cedilla Investment Co., net income of $149,128 for Zeus, net income of $139,783 for KWJ Corp ., a net loss of $21,567 from Brickell, and a net loss of $18,356 from IRA Florida Apts. and reflects the following income and end-of-year balance sheets with respect to IRA (unconsolidated):

IRA

Income
Dividends $343,080
Interest 402,022
Gross rents 2,581,652
Capital gain 314,855
Partnerships (689,461)
Commissions
General fees 244,732
Consulting fees 26,000

Total 3,222,880
Deductions
Bad debts 22,075
Interest 1,834,892
Depreciation 1,636,137
Commissions/fees
Other 88,311

Total 3,581,415
Net Income (358,535)
NOL (1,453,212)
Special deductions (336,303)

Taxable Income (2,148,050)
Assets
Cash 110,281
Pooled funds 38,250
Notes Receivable 2,070,128
Loans
Stockholders 292,260
Others 1,592,983
Securities
Short term 3,776,000
Marketable 564,827
Nonmarketable 192,700
Investment in sub. 83,000
Investment in pship. 1,640,284
Depreciable assets 11,286,020
Less accumulated dep. (7,636,902)
Other 2,365

Total 14,012,196
Liabilities
Payables
Short term 1,341,617
Long term 11,060,633
Deferred gain 1,969,973
Other ----------
Total 14,372,223
Net assets (360,027)
Capital stock
Preferred
Common 100
Capital surplus
Retained earnings (360,127)

1984-87
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT
IS NOT DISPLAYABLE

IRA distributed cash accumulated from Prudential transactions, including cash received from Zeus and the liquidation of KWJ Corp. and its interests in the Essex and Sherwood partnerships, in the ratio of 45 percent each to Carlco and TMT and 10 percent to BWK, Inc. Carlco, TMT, and BWK, Inc., contributed the Hyatt contract rights to a new partnership called KWJ Co.
IRA's consolidated returns for 1984 to 1987 reported the following consolidated net losses, net income or loss for Cedilla Investment Co. and Zeus, and income for IRA, and reflect the following end-of-year balance sheets with respect to IRA (unconsolidated):

1984 1985 1986 1987
--- --- --- ---
Consolidated
income (loss) ($175,946) $96,363 ($327,854) ($16,942)
Cedilla Invest. 331,263 376,929 (1,148,003) (704,460)
Zeus (96,473) (153,108) (151,122) (181,747)
IRA
Income
Dividends 113,505 97,206 87,079 31,960
Interest 247,230 177,236 164,843 238,396
Gross rents 2,689,177 2,689,177 1,175,346 1,271
Capital gain 247,929 -- (62,833) 604,750
Partnerships 24,821 (202,702) 373,779 186,845
Loss notes -- -- -- (1,176,670)
Commissions/fees -- -- -- --
Other 356 1,000 (546) --
--- --- --- ---
Total 3,323,018 2,761,917 1,737,668 (113,448)
Deductions
Bad debts -- -- -- 132,013
Interest 1,778,953 1,477,807 543,077 274
Depreciation 1,748,335 1,222,686 316,192 3,228
Consulting fees -- -- -- --
Commissions -- 4,000 -- --

Other 20,752 22,784 29,683 37,094
---------- ---------- ---------- ----------
Total 3,548,040 2,727,277 888,952 172,609
Net income (225,022) 34,640 848,716 (286,057)
NOL (89,235) (410,736) (458,721) --
Special ded. (96,479) (82,625) (86,412) (31,960)
---------- ---------- ---------- ----------
Taxable income (410,736) (458,721) 303,583 (318,017)

Assets
Cash 53,976 11,933 322,645 1,241,888
Pooled funds 38,250 -- -- --
Notes Receiv. 1,868,086 1,649,390 2,528,266 1,156,439
Loans
Stockholders 292,479 -- -- --
Subsidiaries -- 292,569 345,869 --
Others 1,543,454 1,146,668 1,186,973 620,594
Securities
Short term 422,000 415,000 -- --
Marketable 230,451 -- -- --
Nonmarketable 4,430,107 4,848,613 5,291,069 5,718,826
Invest. sub. 65,000 65,000 65,000 65,000
Invest. pship. 1,129,898 1,041,875 1,194,093 345,491
Deprec. assets 11,286,020 11,286,020 23,721 23,721
Less acc. dep. (9,385,237) (10,607,923) (20,494) (23,721)
Other 2,365 2,365 2,365 2,365)
---------- ---------- ---------- ----------
Total 11,976,849 10,151,510 1 0,939,507 9,150,603
Liabilities
Payables -- -- -- --
Short term 81,250 122,925 45,490 45,490
Long term 11,258,179 9,995,705 9,49 5,319 9,495,280
Defer. gain 1,777,711 1,569,599 2,4 59,893 1,100,516
Other -- -- -- --
---------- ---------- ---------- ----------
Total 13,117,140 11,688,229 1 2,000,702 10,641,286
Net assets (1,140,291) (1,536,719) (1,061,195) (1,490,683)

Capital stock
Preferred -- -- -- --
Common 100 100 100 100
Capital surplus
Retained earn. (1,140,391) (1,536,819) (1,061,295) (1,490,783)

1988-89
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
In December 1988, IRA acquired 850 shares (85 percent) of Decisions Holding Corp. in a section 351 exchange for all of its shares of Cedilla Invest. and Zeus, plus $60,000. [FN25] Zeus continued to hold an $807,028 receivable from Holding Co. plus $64,000 of receivables (exchanged during 1988 for a $64,000 receivable from HELO). No payments were made by Holding Co. or the others on the receivables, and no efforts were ever made to collect on the receivables.
IRA's consolidated returns for 1988 and 1989 reported consolidated net losses, and net income or loss for Cedilla Investment Co., Zeus, and Decisions Holding Corp. and reflected the following income and end-of-year balance sheets with respect to IRA (unconsolidated):

1988 1989
---------- ----------
Consolidated income (loss) ($637,842) ($116,521)
Cedilla Invest.
Net 52,446 11,702
NOL (704,460) (652,014)
---------- ----------
Taxable (652,014) (640,312)
Zeus
Net (163,987) (18,419)
NOL (181,747) (345,734)
---------- ----------
Taxable (345,734) (364,153)
Decisions Holding Corp.

Net income (1,066,348) (3,394)
NOL (1,066,348)
---------- ----------
Taxable income (1,066,348) (1,069,742)
IRA
Income
Dividends 65,093 --
Interest 180,828 120,555
Gross rents 188 --
Capital gain 293,593 780,343
Partnerships 106,970 110,087
Commissions/fees ---------- ----------
Total 646,672 1,010,985
Deductions
Commissions/fees
Other 44,001 59,927
---------- ----------
Total 44,001 59,927
Net income 602,671 951,058
NOL (311,625) (419,626)
Special deductions (52,074) --
---------- ----------
Taxable income 238,972 531,432
Assets
Cash $1,320,716 $611,752
Notes Receivable 879,079 --
Loans
Stockholders -- --
Others 554,969 1,309,744
Securities -- --
Marketable
Nonmarketable 6,145,610 6,806,346
Investment in sub. 125,000 125,000
Investment in pship. 390,091 478,847
Other 2,365 2,365
---------- ----------
Total 9,417,830 9,334,054

Liabilities
Payables/notes
Short term -- --
Long term 9,495,280 9,495,280
Deferred gain 836,581 --
Other ---------- ----------
Total 10,331,861 9,495,280
Net assets (914,031) (161,226)
Capital stock
Preferred -- --
Common 100 100
Capital surplus
Retained earnings (914,131) (161,326)

IRA's records show the following assets (unconsolidated) for the years 1983 through 1989:

[Note: The following TABLE/FORM is too wide to be displayed on one screen.
You must print it for a meaningful review of its contents. The table has been
divided into multiple pieces with each piece containing information to help you
assemble a printout of the table. The information for each piece includes: (1)
a three line message preceding the tabular data showing by line # and
character # the position of the upper left-hand corner of the piece and the
position of the piece within the entire table; and (2) a numeric scale
following the tabular data displaying the character positions.]
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******** This is piece 1. -- It begins at character 1 of table line 1. ********

****

IRA Assets 1983 1984 1985 1986

---------- ---------- ---------- ---------- ---------- --

Cash and CD's
Amer. Natl Bank $58,322 $2,047 -- --
Skylark Bank 49,966 49,966 - -
Perinne Bank 1,993 1,963 -- --
Administration 38,250 38,250 -- --
Co.
CD's 3,776,000 422,000 415,000 -
Special E -- -- 11,933 322,645
Principal -- -- -- --
Services

---------- ---------- ---------- ---------- --

Total 3,924,531 514,226 426,933 322,645
Notes Rec.
PMS Note 2,070,128 1,868,086 1,649, 390 1,412,666
Aura -- -- 175 --
Kanter -- -- 16,612 --
Funding Sys. 183,750 122,500 -- --
The Holding Co. 5,027 -- 45,000 64,000
Int'l Films 532,420 535,520 504,548 507,648
HELO 510,100 502,100 495,500 485,825
Tanglewood 350,000 350,000 -- --
Cedilla Invst. 292,260 292,479 292, 569 345,869
B. DiLanciano 3,334 3,334 3,334 --
Larry Freeman 8,351 -- -- --
KWJ Co. -- 30,000 75,500 1 13,500
Landing -- -- 6,000 --
Forest Activity -- -- -- 16,000
Hyatt Corp. -- -- -- 1,115,560
Cablevision Sys. -- -- -- --
Bea Ritch Trust -- -- - --
MAF, Inc. -- -- -- --
CMB Cin. Vent. -- -- -- --
RWL Cin. Trust -- -- -- --

Decisions -- -- -- --
Holding
Carlco -- -- -- --
TMT -- -- -- --

---------- ---------- ---------- ---------- --

Total 3,955,370 3,704,019 3,088,628 4,061,068
Invest. in Stocks
Newell $14,535 -- -- --
Marmom Group 284,009 -- -- --
Micro Z 74,200 -- -- --
Enterp. Tech. 10,664 -- -- --
Composit Cont. 115,000 $115,000 -- --
Modular Pwr. 12,200 12,200 -- --
Greenwich Pharm. 9,219 -- -- --
Funds for Energy 45,000 45,000 -- --
Int'l Films 65,000 65,000 $65,000 $65,000
Cedilla Invst. 15,000 15,000 15,000 15,000
Zeus 50,000 50,000 50,000 50,000
Walnut Capital 40,000 40,000 40,000 40,000
Geocham 87,700 87,700 -- --
Carlco 6,000 1,856,942 2,040,992 2,203,362
BWK 6,000 417,321 458,221 494,303
TMT 6,000 1,962,144 2,243,400 2,488,403
Brajdas -- 58,251 -- --
Hyatt Air -- 1,000 1,000 --
Decision -- -- -- --
Holdings

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Total 840,527 4,725,558 4,913,613 5,356,068
Partnerships
Micro Z 26,191 28,387 30,104 31, 059
Brickell 135,245 160,559 1 69,885 180,205
Biscayne
TicketMaster 39,631 39,624 39,617 39,615
Polar 1,181,470 879,177 576,587 274,069
May Invest (2,559) (388) (231) (663)
Sandburg Village 650,975 656,929 64 3,088 581,006

UP Associates (211,287) (329,185) (447,41 9) (449,561)
Essex 45,283 -- -- --
Sherwood (51,742) -- -- -- .
Chicago (90,375) (156,319) (224,202) (292,880)
Cablevision
Cablevision (82,547) (148,886) 254, 446 --
Prog.
HICIP -- -- -- 831,243
---------- ---------- ---------- ---------- --
Total 1,640,285 1,129,898 1,0 41,875 1,194,093
Rental property
Cost 11,262,299 11,262,299 11,262,2 99 --
Accum. dep. (7,628,162) (9,371,728) (10,5 90,882) --
---------- ---------- ----------
Total 3,634,137 1,890,571 671,417 --
Other total 17,346 12,577 9,045 5,592
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Total assets 14,012,196 11,976,849 10,151,511 10,939,466
1...+...10....+...20....+...30....+...40....+...50....+...60....+...70....+....
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********** This is piece 2. -- It begins at character 80 of table line 1. *********
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1987 1988 1989
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915,000 998,051 620,000
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326,888 322,665 --

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1,241,888 1,320,716 611,752

1,156,439 879,079 --
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76,743 76,743 76,743
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161,500 181,500 249,870
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181,247 90,624 --
200,000 200,000 200,000
1,002 -- --
102 102 102
-- 6,000 6,000
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1,777,033 1,434,048 1,309,744

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$15,000 -- --
50,000 -- --
80,000 $80,000 $80,000
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2,395,676 2,558,437 2,936,627
530,473 566,642 650,684
2,712,677 2,940,531 3,139,035
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-- 125,000 125,000

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5,783,826 6,270,610 6,931,346

31,059 30,041 30,032
-- -- --

39,615 -- --
(3,269) (3,356) (3,356)
1,138 (2,298) (2,439)
-- -- --
(542,452) (542,489) (542,803)
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-- -- --
(337,678) (364,038) (384,914)

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1,157,078 1,272,231 1,382,327
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345,491 390,091 478,847

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2,365 2,365 2,365
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9,150,603 9,417,830 9,334,054
80..+...90....+....0....+...10....+...

IRA and its subsidiaries' consolidated total income, taxable income, net operating losses, and taxes paid for the years 1978 through 1989 were as follows:

Year	Total Income	Taxable Income	Net Operating Losses	Tax Paid
1978	$1,004,475	($18,673)	($27,394)	--
1979	1,944,332	404,771	(18,673)	$94,618
1980	3,557,198	65,094	--	--
1981	5,158,583	(615,852)	--	--
1982	4,536,122	(121,501)	(143,987)	--
1983	3,849,742	(435,535)	(121,501)	--
1984	3,606,785	(175,964)	(89,235)	--
1985	3,118,893	96,363	(175,946)	--
1986	2,345,762	(328,854)	--	--
1987	299,794	(16,942)	(111,843)	--
1988	(526,393)	(637,842)	(10,550)	--
1989	1,011,577	(116,521)	(1,057,468)	10,819

IRA and its subsidiaries' consolidated total income, rental income, and difference for the years 1978 through 1989 were as follows:

Year	Total Income	Rental Income	Difference
1978	$1,004,475	$241,072	$ 763,403
1979	1,944,332	242,818	1,701,514

1980 3,557,198 831,264 2,725,934
1981 5,158,583 2,740,082 2,418,501
1982 4,536,122 2,681,385 1,854,737
1983 3,849,742 2,820,494 1,029,248
1984 3,606,785 2,928,019 678,766
1985 3,118,893 2,928,019 190,874
1986 2,345,762 1,627,094 718,668
1987 299,794 9,940 298,854
1988 (526,393) 188 (526,205)
1989 $1,011,577 -- 1,011,577

On the consolidated returns, IRA reported that it paid (not including payments by subsidiaries) the following compensation of officers, compensation of directors, salaries and wages, commissions, and consulting fees for the years 1976 through 1989:

Year	Officers	Directors	Wages	Commissions	Consulting
1976	--	--	$213,333	--	
1977	$19,300	--	$986	12,000	--
1978	15,000	--	5,051	207,237	$51,900
1979	--	--	209,440	125,000	
1980	--	--	--	--	
1981	--	$12,500	9,969	115,400	--
1982	--	--	26,079	--	29,000
1983	--	--	--	--	
1984	--	--	--	--	
1985	--	--	4,000	--	
1986	--	--	--	--	
1987	--	--	--	--	
1988	--	--	--	--	
1989	--	--	--	--	

H. Changes in Holding Co. & Subsidiaries Corporate Structure 12/76 Through 8/87
Holding Co. was incorporated on December 8, 1976. Holding

Co.'s return for the fiscal year ending August 31, 1978, indicates that Kanter owned 75 percent of Holding Co.'s voting stock as of the close of the taxable year. The return indicates that preferred shares as well as common shares of stock were outstanding at that time.
12/76 Through 8/31/77
By August 31, 1977, Holding Co. had acquired Citra Co. (Citra).
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
9/1/77 Through 8/31/78
On November 25, 1977, Holding Co. had acquired 1,000 shares (100 percent) of the common stock (no preferred stock was issued) of The Active Business Corp. (Active). On July 21, 1978, Active acquired 500 shares (100 percent) of the voting stock of Harbor Investments, Inc., which later changed it name to Harbor Exchange Lending Operation (HELO).
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
9/1/78 Through 8/31/79
On May 22, 1979, Holding Co. acquired 1,000 shares (100 percent) of the voting stock of Oil Investments, Ltd. (Oil Investments).
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
9/1/79 Through 8/31/80
Holding Co. acquired 1,000 shares (100 percent) of the voting stock of The Nominee Corp. (Nominee) on January 7, 1980, and 100 shares (100 percent) of the voting stock of Tanglewood Properties, Inc., on April 30, 1980. Harbor Investments changed its name to Harbor Exchange Lending Operations (HELO) between September 1, 1979, and August 31, 1980.
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
9/1/80 Through 8/31/81

Holding Co. acquired the voting stock of L.B.G. Properties, Inc. (LBG Prop.), in November 1980, Zion in December 1980, and Twilight Properties, Inc. (Twilight), in April 1981.
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
9/1/81 Through 8/31/83
Between August 31, 1981, and August 31, 1983, Holding Co. acquired 100 percent of the voting shares of Columbus Projects, Inc. (Columbus), PPPD, Inc. (PPPD), and PPPI, Inc. (PPPI). In 1981 Frey began making payments to Zion, and in 1982 Essex began making payments to Holding Co.
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
9/1/83 Through 8/31/84
In 1984, Schaffel began making payments to Holding Co. On August 31, 1984, Holding Co. sold or liquidated all of its stock in Active, Citra, Columbus, HELO, PPPD, and PPPI.
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
9/1/84 Through 8/31/85
On August 31, 1985, Holding Co. sold or liquidated its stock in Nominee. It reacquired the stock in Nominee on September 1, 1986.
I. Holding Co. & Subsidiaries Returns
The consolidated returns of Holding Co. and its subsidiaries show the following with respect to taxable years ending July 31, 1977 to 1987:

[Note: The following TABLE/FORM is too wide to be displayed on one screen.
You must print it for a meaningful review of its contents.
The table has been
divided into multiple pieces with each piece containing information to help you
assemble a printout of the table. The information for each piece includes: (1)
a three line message preceding the tabular data showing by

line # and
character # the position of the upper left-hand corner of the piece and the
position of the piece within the entire table; and (2) a numeric scale
following the tabular data displaying the character positions.]
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	8/31/77	8/31/78	8/31/79	8/31/80
Income (loss)				
Consolidated				
Income --	$594,653	$900,572	$1,076,933	
Deductions --	(613,972)	(813,324)	(939,205)	
Net --	(19,319)	87,248	137,728	
NOL & Special --	(112,776)	(160,468)	(99,377)	
Taxable --	(132,095)	(73,220)	38,351	
Active				
(acq.11/77)				
Income --	59,961	28,387	49,902	
Deductions --	(1,106)	(3,468)	(5,863)	
Net --	58,855	14,919	44,039	
NOL --	--	(1,658)	--	
Taxable --	58,855	13,261	44,039	
Citra				
Income --	19,327	82	6	
Deductions --	(335)	(211)	(1,221)	

Net -- 18,992 (129) (1,215)
NOL -- -- -- (129)
---------- ---------- ----------
Taxable -- 18,992 (129) (1,344)
HELO
(acq.7/78)
Income -- -- -- 1,485
Deductions -- -- (115) (31,309)
---------- ----------
Net -- -- (115) (29,824)
NOL -- -- -- (115)
---------- ----------
Taxable -- -- (115) (29,939)
Nominee
Income -- -- -- --
Deductions -- -- -- (31)

Net -- -- -- (31)
NOL -- -- --
Taxable -- -- -- (31)
Oil Investments
Income -- -- -- (444,493)
Deductions -- -- (54) (28,227)
---------- ----------
Net -- -- (54) (472,720)
NOL -- -- -- (54)

Taxable -- -- (54) (472,774)
Tanglewood
Income -- -- -- $246,059
Deductions -- -- -- (241,573)

Net -- -- -- 4,486
NOL -- -- -- --

Taxable -- -- -- 4,486
Holding Co.

Income
Dividends -- $118,940 $35,069 30,773
Interest -- 284,413 449,889 182,802
Gross rents -- 182,357 264,538 264,338
Capital Gain -- (35,277) 272,693
Partnerships -- (118,638) 58,819 (240,878)
Commissions -- 92,792 63,788 75,000
Consulting fees -- -- -- --
Condo conversion -- -- -- 579,394
Other 59,852
---------- ---------- ----------
Total 524,587 872,103 1,223,974
Deductions
Bad debts -- -- -- --
Interest -- 176,936 477,517 372,691
Depreciation -- 442,276 315,911 225,651
Commissions
Consulting -- -- -- 15,000
Legal & profess. -- -- 5,796 15,297
Other -- 2,541 252 2,342
---------- ---------- ----------
Total -- 621,753 799,476 630,981
Net Income -- (97,166) 72,627 592,993
NOL -- -- (209,008) (166,190)
Special ded. -- (112,776) (29,809) (26,157)
---------- ---------- ----------
Taxable Income -- (209,942) (166,190) 400,646
Holding Co.
Assets -- -- -- -- --
Cash 27,199 3,012 (14,850) 31,613
Dividends receiv. -- 77,847 -- --
Mortgage Loan -- 94,479 14,479 --
Loans
Stockholders 161,500 197,638 40, 316 --
Subsidiaries
Others 2,371,000 5,325,153 12,18 8,227 15,378,662
Securities

Marketable $263,887 $2,177,889 $ 1,299,799 $2,076,472
Nonmarketable 34,956 99,888 207,139 511,042
Invest. sub. 50,000 100,000 178,849 180,849
Invest. pship. 70,890 82,406 350,033 42,755
Deprec. assets -- 1,547,966 1,547,966 1,547,966
Less acc. dep. -- (442,276) (758,187) (983,838)
Land -- -- -- 5,000
Other 9,899 3,039 2,999 4,103

Total 2,989,331 9,267,041 15, 056,770 18,794,624
Liabilities
Loans/notes
Short-term 550,000 833,758 1,142,616 579,246
Long-term 2,269,000 6,743,486 13,150,752 16,528,988
Stockholder 45,000 138,000 -- 126,431
Subscription -- -- 45,000 45,000
Due broker -- 1,068,091 36 3,498 567,487
Other 86,314 131,946 -- --

Total 2,950,314 8,915,281 14,701,866 17,847,152
Net assets 39,017 351,760 354,904 947,472
Capital stock
Preferred 275 50,778 50,778 50,778
Common 2 23 23 23
Capital surplus 49,723 407,086 407,086 407,086
Retained earn. (10,983) (106,127) (102,983) 489,585
HELO
Assets
Cash -- -- 231 4,294
Pooled funds -- -- - 718
Loans receiv. -- -- -- --
Others -- -- -- 2,871,082
Other -- 500 151 120

Total 500 382 2,876,214
Liabilities
Payables -- -- -- --

Short-term -- -- -- 322,987
Long-term -- -- -- 1,327,100
Shareholder -- -- -- 1,255,600

Total -- -- -- 2,905,687
Net assets -- 500 382 (29,473)
Capital stock
Preferred -- -- -- --
Common -- 500 500 500
Capital surplus -- -- -- --
Retained earn. -- -- (1 18) (29,973)

8/31/83 8/31/84 8/31/85 8/31/86

Income (loss)
Consolidated
Income -- 2,747,847 5,453,080 2,103,200
Deductions -- (3,982,819) (4,028,682) (1,824,013)
Net -- (1,234,972) 1,424,398 279,187
NOL & special -- (6,317,893) (7,355,261) (5,932,002)
Taxable (6,316,713) (7,552,865) (5,930,863) (5,652,815)
Active
Income -- (22,311) -- --
Deductions -- (71,467) -- --
Net -- (93,778) -- --
NOL -- (1,648,466) -- --
Taxable (1,648,466) (1,742,244) -- --
Citra
Income -- 60 -- --
Deductions -- (699) -- --
Net -- (639) -- --
NOL -- -- -- --
Taxable (639) (639) -- --
Columbus Projects
Income -- (41,684) -- --
Deductions -- (169) -- --
Net -- (41,853) -- --

NOL -- (70,273) -- --
Taxable (70,273) (112,126) -- --
HELO
Income -- 136 -- --
Deductions -- (30) -- --
Net -- 106 -- --
NOL -- (198,135) -- --
Taxable (198,135) (198,029) -- --
LBG Properties
Income -- 257,663 219,000 382,823
Deductions - (277,218) (219,062) (461,384)
Net -- (19,555) (62) (78,561)
NOL -- (273,136) (292,691) (292,753)
Taxable (273,136) (292,691) (292,753) (371,314)
Nominee
Income -- -- 52 --
Deductions -- (618) (290) --
Net -- (618) (238) --
NOL -- (512) (1,130) --
Taxable (512) (1,130) (1,368) --
Oil Investments
Income -- (81,457) 8,088 (121,884)
Deductions -- (430) (11,623) (3,689)
Net -- (81,887) (3,535) (125,573)
NOL -- (1,652,325) (1,734,212) (1,737,747)
Taxable (1,652,325) (1,734,212) (1,737,747) (1,863,320)
PPPD, Inc.
Income -- -- -- --
Deductions -- (375) -- --
Net -- (375) -- --
NOL -- (292) -- --
Taxable (292) (667) -- --
PPPI, Inc.
Income -- -- -- --
Deductions -- (365) -- --
Net -- (365) -- --
NOL -- (283) -- --

Taxable (283) (648) -- --
Tanglewood
Income -- 836,977 313,280 290,446
Deductions -- (763,046) (322,830) (462,098)
Net -- 73,931 (9,550) (171,652)
NOL -- (260,287) (186,356) (195,906)
Taxable (260,287) (186,356) (195,906) (367,558)
Twilight Prop.
Income -- 1,336,393 3,531,431 45,893
Deductions -- (2,334,351) (2,537,970) (260,027)
Net -- (997,958) 993,461 (214,134)
NOL -- (2,316,873) (3,314,831) (2,321,370)
Taxable (2,316,873) (3,314,831) (2,321,370) (2,535,504)
Zion
Income -- (93,233) (262,786) (315,749)
Deductions -- (396) (354) (1,120)
Net -- (93,629) (263,140) (316,869)
NOL -- (216,308) (309,937) (573,077)
Taxable (216,308) (309,937) (573,077) (889,946)
Holding Co.
Income
Dividends -- 1,388 500 2,949
Interest -- 60,937 75,996 175,522
Gross rents -- 262,138 262,138 129,200
Capital gain -- 487,794 821,186 (229,447)
Partnerships -- (343,048) (352,711) (219,551)
Commissions -- 14,341 266,650 1,100,000
Other fees -- 69,496 414,036 441,723
Condo conversion -- -- --
Other -- 2,257 156,220 --
--- --- ---
Total -- 555,303 1,644,015 1,400,396
Deductions
Bad debts -- -- 30,000 45,000
Interest -- 68,129 146,076 141,905
Depreciation -- 135,847 8,511 21,167
Commissions/fees -- 875 600,000 175,000

Legal & profess. -- 302,900 116,492 222,678
Other -- 25,904 35,474 29,945
---------- ---------- ----------
Total -- 533,655 936,553 635,695
Net Income -- 21,648 707,462 764,701
NOL -- -- -- (1,149,287)
Active -- -- (1,742,244) --
Citra -- -- (639) --
Columbus Proj. -- -- (112,126) --
PPPD -- -- (667) --
PPPI -- -- (648) --
Special ded. -- (1,180) (425) (2,507)
---------- ---------- ----------
Taxable income -- (20,468) (1,149,287) (387,093)
Holding Co.
Assets
Cash 103,880 215,579 190,832 129,934
Pooled funds 18,882 119,338 677,730 1,127,458
CD -- -- -- 1,060,000
Loans -- -- -- --
Stockholders 111,301 19,785 19,785 975,000
Others 5,219,398 4,023,564 4,476,787 2,218,852
Securities
Marketable 788,807 1,351,225 1,712,093 358,991
Nonmarketable 336,451 276,075 227,735 234,402
Invest. sub. 223,932 36,060 36,060 25,060
Invest. pship. (1,509,414) (3,628,091) (4,429,619) (4,191,984)
Condominiums -- -- -- 250,484
Deprec. assets 1,549,027 1,557,732 1,844,476 1,844,476
Less acc. dep. (1,413,981) (1,549,828) (1,558,338) (1,579,505)
Other 2,910 2,910 9,743 11,603
---------- ---------- ---------- ----------
Total 5,431,193 2,424,349 3,2 07,284 2,464,771
Liabilities
Loans/notes -- -- -- --
Short-term 2,046,772 1,404,904 1,484,337 --
Long-term 923,529 991,950 1,045,743 --

Stockholder 425,528 33,620 -- --
Deferred income 26,238 11,554 11,554 --
Other 49,750 4,750 4,750 --
---------- ---------- ----------
Total 3,471,817 2,446,778 2,546,384 --
Net assets 1,959,376 (22,429) 660,900 --
Capital stock
Preferred 50,780 50,780 -- --
Common 23 23 -- --
Capital surplus 1,907,085 1,907,085 -- --
Retained earn. 1,488 (1,980,317) -- --
HELO
Assets -- -- -- --
Cash 31 322 -- --
Pooled funds -- 4,636 -- --
Loans Receiv. 2,331,326 1,320,059 -- --
Other assets 27 -- -- --
---------- ----------
Total 2,331,384 1,325,017 -- --
Liabilities
Payables
Short-term 2,518,589 -- -- --
Long-term 10,557 1,522,700 -- --
---------- ----------
Total 2,529,146 1,522,700 -- --
Net assets (197,762) (197,683) -- -
Capital stock
Preferred -- -- -- --
Common 500 500 -- --
Capital surplus
Retained earn. (198,262) (198,183) -- --
Zion
Assets
Cash (84) 7 55 9,719
Pooled funds -- 2,818 7,100 --
Marketable sec. -- 127,280 127,280 65,695
Invest. pship. 840,362 618,059 344,295 85,912

Other 5,345 2,524 -- --
---------- ---------- ---------- ----------
Total 845,623 750,688 478,730 161,326
Liabilities
Loans/notes
Short-term 9,264 3,014 -- --
Long-term 104,694 104,694 99,871 --
Stockholder 629,650 636,000 636,000 636,000
Other -- -- -- 99,336
---------- ---------- ---------- ----------
Total 743,608 743,708 735,871 735,336
Net assets 102,015 6,980 (257,141) (574,010)
Capital stock
Preferred 8,000 8,000 8,000 8,000
Common 100 100 100 100
Capital surplus 133,250 133,250 133,25 0 133,250
Retained earn. (39,335) (134,370) (398,491) (715,360)
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******** This is piece 2. -- It begins at character 75 of table line 1. ********
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8/31/81

$1,110,335
(3,828,869)

(2,718,534)
(80,124)

(2,798,65 8)

23,768
(4,381)

19,387
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19,387

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(20)
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(20)
(1,344)

(1,364)

4,597
(149,974)

(145,377)
(29,939)

(175,316)

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(1,589)

(1,589)
(31)
(1,620)

(619,431)
(5,637)

(625,068)
(472,774)

(1,097,842)

$818,591
(1,122,339)

(303,748)
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(303,748)

78,130
80,077
264,938

(405,693)
344,175
150,000
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511,627

799,552
1,160,279
161,179

600
2,689
14,192

2,138,491
(1,626,864)
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(66,950)

(1,693,814)

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(590,353)
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4,228,168

$235,609
455,828
194,447
263,305
1,547,966
(1,145,017)
5,000
3,170

5,198,123

2,546,566
1,352,085
334,983
53,000
651,595
969

4,939,198
258,925

1,550,778
23
407,086
(1,698,962)

(879,704)
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4,691,912
348

3,812,556

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849,680
3,127,200
10,557

3,987,437
(174,881)

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500
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(175,381)

8/31/87

607,736
(1,118,480)
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(5,655,428)
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300,000
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(1,451)

11,981
(291)
11,690
(1,863,320)
(1,851,630)

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196,544
(184,525)
12,019
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(2,535,504)
(2,535,504)

(84,538)
(120)
(84,658)
(889,946)
(974,604)

3,266
145,483
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(32,398)
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(498)

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633,397
(541,102)
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(2,613)

(930,808)

(396,758)
1,048,386
970,500
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700,000
4,490,268

198,991
235,903
36,060

(4,608,659)
250,484
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75..80....+..

J. HELO 1979 Through 1983
Holding Co.'s consolidated returns reflect the following income (all interest), deductions, net assets, and stockholder equity with respect to HELO:

08/78 08/79 08/80 08/81 08/83 08/84
---- ---- ---- ---- ---- ----

Interest	$-0-	$1,485	$4,597	N/A	$136
Deductions	(115)	(31,309)	(149,974)		(30)
Total	(115)	(29,824)	(145,377)		106
NOL		(115)	(29,939)	(198,135)	
Taxable		(115)	(29,939)	(175,316)	(198,029)
Assets					
Cash	$500	131	4,294	(879,704)	$31 322
Receivables		2,871,082	4,691,912	2,331,326	1,320,059
Money market			718	259	
Pooled funds				4,636	
Intangibles		151	120	89	27
Total	500	382	2,876,214	3,812,556	2,331,384 1,325,017
Liabilities					
Loans					
Short-term		322,987	849,680	2,518,589	1,522,700
Shareholder			1,255,600	10,557	
Long-term			1,327,100	3,127,200	10,557
Total	-0-	-0-	2,905,687	3,987,437	2,529,146 1,522,700
Net assets	500	382	(29,473)	(174,881)	(197,762) (197,683)
Capital stock	500	500	500	500	500 500
Retained earnings		(118)	(29,973)	(175,381)	(198,262) (198,183)

IV. Flow of Money

A. Payments to IRA and Subsidiaries: The Prudential Transactions

1. Overview

The payments related to the Prudential transactions paid by the Five to IRA and its subsidiaries during the years 1977

through 1989, were as follows:

Year	Hyatt 1	Schaffel	Frey	PMS	Essex	Total
1977	$38,394					$38,394
1978	42,517					42,517
1979	119,719	$100,000		$303,088		522,807
1980	244,920	$127,372		380,337		752,629
1981	90,070	361,525		105,764	534,696	1,092,055
1982	172,702	447,450		538,781	361,692	$86,212 1,606,837
1983	172,090	30,981		110,125	361,692	78,376 753,264
1984	186,092	103,500		361,692	133,238	784,522
1985	206,790	128,763		361,692	120,175	817,420
1986	231,263	361,692		80,466		673,421
1987	229,449	361,692		120,698		711,839
1988	197,348	361,692		117,563		676,603
1989	52,777	840,423		51,727		944,927
Total	1,739,211	1,184,876		1,114,305	4,590,388	788,455
$9,417,235						

FN1. Net Weaver's 30%.

Prior to 1984, all payments related to the Prudential transactions were paid to IRA or one of its subsidiaries. By early 1982, Ballard and Lisle had left Prudential. During 1982 Carlco, TMT, and BWK, Inc. were formed. In 1983 the three corporations became part of IRA's consolidated group, KWJ Corp. was liquidated, and the funds accumulated by Zeus were distributed to IRA. In 1984, IRA distributed the funds that had been accumulated from the Prudential transactions in the ratio of 45 percent to Carlco, 45 percent to TMT, and 10 percent to BWK, Inc. From 1984 through 1989, most payments related to the Prudential transactions were paid to or distributed to Carlco, TMT, and BWK, Inc.

2. Flow of the Funds 1977 Through 1983

The following diagram shows the money paid by the Five to

IRA, Zeus, and KWJ Corp. from 1977 through 1983 with respect to the Prudential transactions:
1977-1983
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
Prior to 1984, all payments by the Five in connection with the Prudential transactions were reported on the consolidated returns of IRA. No tax was paid on this income because, during the years 1978 through 1983, IRA reported substantial net operating losses. IRA reported the following consolidated total income, taxable income, and net operating losses for the years 1978 through 1983:

Year	Total Income	Taxable Income	Net Operating Losses
1978	$1,004,475	($18,673)	($271,394)
1979	1,944,332	404,771	(18,673)
1980	3,557,198	65,094	--
1981	5,158,583	(615,852)	--
1982	4,536,122	(121,501)	(143,987)
1983	3,849,742	(435,535)	(121,501)

a. Flow of Money From KWJ Corp. to IRA: 1978 Through 1983
IRA acquired all of KWJ Corp.'s stock from Weaver in 1979. At the time of the purchase, KWJ Corp. had net assets of $115,084. IRA's consolidated returns from 1979 through 1983 reported the following income, net assets, and stockholder equity with respect to KWJ Corp.:

[Note: The following TABLE/FORM is too wide to be displayed on one screen.
You must print it for a meaningful review of its contents.
The table has been divided into multiple pieces with each piece containing information to help you
assemble a printout of the table. The information for each piece includes: (1)

a three line message preceding the tabular data showing by line # and
character # the position of the upper left-hand corner of the piece and the
position of the piece within the entire table; and (2) a numeric scale
following the tabular data displaying the character positions.]

********** ******** This is piece 1. -- It begins at character 1 of table line 1. ******** **********

	1978	1979	1980	1981	1982
Income					
Commission	--	$171,027	--	$128,671	$246,717
Interest - 703	--	2,512	6,237		
Total	--	171,730	--	131,183	252,954
Deductions	--	--	--	--	--
Commission	--	51,308	--	38,601	74,015
Consulting	--	--	--	--	21,000
Other	--	776	$2,620	1,464	2,097
Total	--	52,084	2,620	40,065	97,112
Net Income	--	119,646	(2,620)	91,118	155,842
Assets	$40,626	--	--	--	--
Cash	108,521	3,095	503	1,828	79,950
Accrued income	--	171,000	--	--	--
Pool funds	--	--	--	--	76,720
Loans					
Stockholders(IRA)	--	171,000	262,400	2,400	
Others	--	66,241	66,241	--	--

Total 149,147 $240,364 237,744 264,228 159,070
Liabilities 34,063 65,634 65,634 1,000
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Net assets 115,084 174,730 172,110 263,228 159,070
-- -- -- -- --
Capital stock 1,000 1,000 1,000 1,000 1,000
Capital surplus -- -- -- -- --
Retained earnings 114,084 173,730 171,110 262,228 158,070

Distributions -- 60,000 -- -- 260,000
1...+...10....+...20....+...30....+...40....+...50....+...60....+...70....+....
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********** This is piece 2. -- It begins at character 80 of table line 1. *********
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1983 Total
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$245,84. 792,258
4,356 13,808
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250,199 806,066
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73,753 23 7,677
36,000 57,000
663 7,620
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110,416 302,297
139,783 503,769

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298,853 --

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80..+...90....+....0....

KWJ Corp. paid Weaver a total of $237,677 as commissions from 1979 through 1983. KWJ Corp. paid $21,000 as consulting fees to unidentified payees during 1982. KWJ Corp. paid three of Ballard's and Lisle's children (Melinda Ballard, Thomas Lisle, and Amy Albrecht) $1,000 each month during 1983 and deducted the $36,000 as consulting expenses for 1983. KWJ Corp. had a total of $7,620 in other expenses from 1979 through 1983.
In 1979, KWJ Corp. distributed $60,000 to IRA. During 1981 KWJ Corp. distributed $262,400 to IRA that was treated as a loan from KWJ Corp. to IRA. In 1982, an offset of $260,000 of the loan was treated as a dividend distribution to IRA. In 1983, IRA repaid the remaining $2,400 loan. During 1983, KWJ Corp. was liquidated, and $298,853 was distributed to IRA.
From 1979 through 1983, KWJ Corp. had available or received a total of $921,150 from the following sources:
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE
KWJ Corp. distributed the $921,150 as follows:
TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE

b. Flow of Money From Zeus: 1979 Through 1983
In 1979, IRA organized Zeus and acquired all the common stock for $50,000. The $50,000 paid by IRA for the stock was recorded on the books as $100 for the common stock and $49,900 as paid in capital. IRA also lent Zeus $50,000. In 1979, Zeus purchased a 6.14-percent interest in Village of Kings Creek (Frey's first condominium conversion project) for $100,000.
The Frey corporation paid the following amounts to Zeus during the years 1980 through 1983:

Year	Payment
1980	$127,372
1981	105,764
1982	538,781
1983	110,125
Total	$882,042

All of Zeus' income from its incorporation through 1983 is attributable to the payments from the Frey corporation, interest income, and partnerships (including Frey condominium partnership, the Village of Kings Creek, and the Greens). IRA's consolidated returns for 1979 through 1983 reported the following income, net assets, and stockholder equity with respect to Zeus:

	1979	1980	1981	1982	1983
Income					
Interest	--	--	--	$64,688	$55,104
Commission	--	$127,372	$64,574	538,781	110,125
Partnership	--	--	2,382	(150,907)	(15,049)
Other fees	--	--	32,567	--	--
Misc.	--	--	8,625	12	--

Total income	--	127,372	108,148	452,574	150,180
Deductions	--	9,103	261	3,883	1,052
Taxable	--	118,269	107,887	448,691	149,128
Nontaxable	--	--	--	--	--
Partnership	--	6,828	--	(27,061)	(753)
Assets					
Cash	--	393	27,990	284	7,832
Loan receiv.	--	--	64,000	64,000	866,000
Securities	--	--	--	685,000	--
Money market	--	--	69,002	--	--
Partnerships	$100,000	234,200	172,896	(5,073)	(20,875)
Pooled funds	--	--	--	11,339	--
Intangibles	--	128	96	64	32
Total	100,000	234,721	333,984	755,614	852,989
Liabilities	50,000	59,624	51,000	51,000	--
Net assets	50,000	175,097	282,984	704,614	852,989
Capital stock	100	100	100	100	100
Capital	--	--	--	--	--
surplus	49,900	49,900	49,900	49,900	49,900
Retained	--	--	--	--	--
earnings	125,097	232,984	654,614	802,989	

The $50,000 liability in 1979 and $51,000 of the liabilities reflected on the balance sheet from 1980 through 1982 represented loans outstanding from IRA to Zeus. The $64,000 loan receivable is shown on Zeus' general ledger for 1984 as owed to Zeus by Holding Co .'s subsidiary HELO. At the close of 1982, Zeus had liquid assets of $696,623 ($284 cash, $685,000 money market funds, and $11,339 in pooled funds). During 1983 Zeus received cash income of $165,229 ($55,104 interest and $110,125 commissions) and had cash

expenditures of $1,020 ($1,052 deductions less $32 for capitalized organizational expenses). Thus, during 1983, Zeus had $860,832 in liquid assets ($696,623 + $165,229--$1,020).

On March 25, 1983, Zeus repaid the $51,000 loan outstanding from IRA. On October 21, 1983, Zeus transferred $774,000 to IRA in exchange for a $774,000 receivable from Holding Co. During 1983, Zeus transferred $28,000 to IRA in exchange for $28,000 of receivables from Holding Co. [FN26] Thus, during 1983, Zeus transferred a total of $853,000 in cash to IRA in repayment of a loan and in exchange for Holding Co. receivables.

IRA's 1983 consolidated return reported that Zeus' assets at the end of the year included cash of $7,832, loans receivable of $866,000, partnership interests with a negative value of $20,875, and other assets (capitalized organizational expenses) of $32. From 1979 through 1983, Zeus apparently invested a net of $163,685 in partnerships. [FN27]

From 1979 through 1983, Zeus received a total of $1,111,470 from the following sources:

TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE

Zeus distributed the $1,111,470 of funds as follows:

TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE

c. Payments From Schnitzer-PMS, Essex, and Schaffel 1979 Through 1983

From 1979 through 1983, Essex paid IRA a total of $164,587, PMS paid IRA a total of $1,941,505 in principal and interest on the repurchase of the PMS stock, and Schaffel paid $1,184,876 to IRA representing 50 percent of the broker's fees he received from Prudential transactions. [FN28]

d. Funds Accumulated in IRA at Close of 1983

At the close of 1983, IRA had accumulated $4,771,445 from payments made by the Five related to the Prudential transactions as shown in the following diagram:

TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT

IS NOT DISPLAYABLE

IRA's balance sheet showed the following assets, liabilities, and stockholder equity at the close of 1983:

Assets
Cash $110,281
Notes/accounts receivable 2,070,128
Loans receivable 1,592,983
Short-term securities 3,776,000
Loans to stockholders 292,260
Investment/partnerships 1,640,284
Investment/subsidiaries 83,000
Marketable securities 564,827
Non-marketable securities 192,700
Pooled funds 38,250
Buildings & other depreciable assets 11,286,020
Less accumulated depreciation (7,636,902)
Deposits 2,365

Total 14,012,196
Liabilities
Short-term mtg., notes, bonds 1,341,617
Long-term mtg., notes, bonds 11,060,633
Deferred gain 1,969,973

Total 14,372,223
Net assets (360,027)
Capital stock 100
Retained earnings (360,127)

3. 1984 Distributions to Carlco, TMT, and BWK, Inc.

In 1984, IRA began distributing cash and other property to Carlco, TMT, and BWK, Inc. The distributions were made in a ratio of 45/45/10 to Carlco, TMT, and BWK, Inc.

a. 1984 Distributions of Cash From IRA to Carlco, TMT, and BWK, Inc.

During 1984, IRA transferred $4,156,739 to Carlco, TMT, and

BWK, Inc. The $1,870,532 to each of Carlco and TMT and $415,675 to BWK, Inc., was distributed on the dates and in the amounts indicated:

Date	Carlco	TMT	BWK, Inc.	Total
01/04/84	$540,000	$540,000	$120,000	$1,200,000
01/10/84	90,000	90,000	20,000	200,000
01/13/84	90,000	90,000	20,000	200,000
01/17/84	112,500	112,500	25,000	250,000
01/24/84	225,000	225,000	50,000	500,000
02/01/84	90,000	90,000	20,000	200,000
02/06/84	112,500	112,500	25,000	250,000
02/07/84	90,000	90,000	20,000	200,000
02/10/84	90,000	90,000	20,000	200,000
02/15/84	45,000	45,000	10,000	100,000
02/22/84	36,900	36,900	8,200	82,000
02/29/84	45,000	45,000	10,000	100,000
03/20/84	142,086	142,086	31,575	315,747
04/12/84	40,500	40,500	9,000	90,000
07/17/84	52,200	52,200	11,600	116,000
07/31/84	11,700	11,700	2,600	26,000
10/10/84	16,456	16,456	3,658	36,570
10/16/84	40,690	40,690	9,042	90,422
Total	1,870,532	1,870,532	415,675	4,156,739

b. 1984 Distribution of Essex Partnership Interest to Carlco, TMT, and BWK, Inc.
For the taxable years 1982 through 1983, Essex made the following distributions to IRA that were reported by IRA in the year indicated:

Payment Date	Year Reported	Amount
09/28/82	1982	$47,025
12/30/82	1983	39,187
06/03/83	1983	26,125
07/08/83	1983	26,125
10/03/83	1983	26,125
Total		164,587

IRA also recorded its distributable share of income from Essex as $89,214 for 1982 and $120,656 for 1983. IRA recorded the value of its interest in Essex as follows:

1982 beginning value --	
Plus 1982 share of income	$89,214
Less 11/30/82 payment	(47,025)
Investment end of 1982	42,189

1983 beginning value	42,189
Plus 1983 share of income	120,656
Less distributions	
01/06/83 dividend	(39,187)
06/07/83 distribution	(26,125)
07/11/83 distribution	(26,125)
10/15/83 distribution	(26,125)
Investment end of 1983	45,283

During 1984, IRA received the following distributions from Essex:

01/26/84	Distrib from Essex $44,413
05/08/84	Essex 26,125
07/06/84	Essex distrib. 26,125
10/04/84	Essex 36,575

IRA recorded the receipt of the $44,413 payment received from Essex in January as payables of $19,986 due to each of

January 30, 1984, IRA issued checks in the appropriate amounts to each of the corporations and recorded the payments as payment of the payables owed to Carlco, TMT, and BWK, Inc. The remaining $88,825 from Essex was also treated as distributed directly to Carlco, TMT, and BWK, Inc., by reducing the additions to capital attributable to IRA's contributions of cash made to the corporations during the year.
In December 1984, IRA distributed its Essex partnership interest in the ratio of 45 percent each to Carlco and TMT and 10 percent to BWK, Inc. IRA recorded the distribution of the Essex partnership interest on its books as follows:

1984 beginning value $45,283
Less distribution of investment as paid in capital (45,283)
Less distributions from Essex
05/08/84 (26,125)

10/04/84 (36,575)
Plus "distb exxex dist as pd in" 88,825

Investment end of year -0-

Carlco, TMT, and BWK, Inc. recorded the receipt of the Essex partnership interest as follows (balance differences are due

Item Carlco TMT BWK Total

Investment in Essex
Beginning year -0- -0- -0- -0-
Essex interest from IRA $20,377 $20,377 $4,528 $45,282
K-1 from Essex 60,520 60,520 13,449 134,489
Distribution from Essex (19,986) (19,986) (4,441) (44,413)
1984 Essex distribution from IRA (39,971) (39,971) (8,882)

(88,824)

End year investment 20,940 20,940 4,653 46,533

Paid in Capital
Essex interest from IRA 20,377 20,377 4,653 45,282
Essex distribution received from IRA (39,971) (39,971) (8,882)
(88,824)

c. Transfer of Sherwood Partnership Interest From IRA to Carlco, TMT, and BWK, Inc.
In 1982, IRA invested $175,000 in a partnership called Sherwood Associates (Sherwood). IRA held a 50-percent interest in Sherwood and reported an $89,577 loss from Sherwood for 1982. IRA's Sherwood partnership interest was reflected on IRA's books at the end of 1982 as follows:

Opening balance --
Record transactions thru Nov. 1982 $100
Transfer via Administration Co. client 124,900
Reclassify loan to investment 50,000
Adjustment for 1982 loss (89,577)

Account total 85,423

In 1983, IRA invested an additional $150,000 in Sherwood and IRA was allocated a $287,165 loss for the year. IRA's interest in the Sherwood partnership was reflected on the books at the end of 1983 as follows:

Opening balance $85,423
Contribution to partnership 150,000
1983 loss (287,165)

Account total (51,742)

On December 31, 1984, IRA transferred its 50-percent

interest in the Sherwood partnership, 45 percent each to Carlco and TMT and 10 percent to BWK, Inc. As a result, Carlco and TMT each received a 22.5-percent interest in the Sherwood partnership and BWK, Inc., received a 5-percent interest. IRA reported a gain of $51,742 (the excess of the $376,742 of total losses claimed over IRA's total investment of $325,000) on the transfer of its interest in Sherwood and recorded the transfer on its books as follows:

Investment in Sherwood
Opening balance ($51,742)
Gain on distribution of Sherwood 51,742

Account total 0

Investment in Carlco
Rec. gain on dist of Sherw 1

Investment in TMT
Rec. gain on dist of Sherw 1
Investment in BWK, Inc.
Rec. gain on dist of Sherw 1

Adjusting Journal Entry 21
Invest in Sherwood 51,742
Invest in Carlco 1
Invest in BWK 1
Invest in TMT 1

Gain on sale of Pship 51,745

Carlco, TMT, and BWK, Inc., recorded the contribution of the Sherwood partnership as follows:

Carlco TMT BWK, Inc.
--- --- ---
Investment in Sherwood

Opening balance -- -- --
Sherwood Associates $41,400 $41,400 $9,200
Rec. int. Sherwood from IRA 1 1 1
Rec. K-1 activity (119,116) (119,116) (26,470)
--- --- ---
Paid-in Capital (77,715) (77,715) (17,269)

Rec. int. Sherwood from IRA 1 1 1

d. 1984 Distributions to Carlco, TMT, and BWK, Inc. as Reflected on the Books of the Corporations
The transfers of cash to Carlco, TMT, and BWK, Inc., were recorded on the books of the corporations as, respectively, contributions of capital. The distribution of the Essex partnership interest was recorded as paid-in capital of $20,377 each to Carlco and TMT and $4,528 to BWK, Inc. The distribution of the Sherwood partnership interest was recorded as paid-in capital of $1 each to Carlco, TMT, and BWK, Inc. Additionally, a receivable of $148 for the preferred shares of each of Carlco, TMT, and BWK, Inc. was treated as paid-in capital of each corporation. Thus, amounts recorded as additions to capital during 1984 and total paid-in capital at the close of 1984 for each of the corporations were as follows (balance differences are due to rounding):

Item Carlco TMT BWK, Inc.
--- --- --- ---

Cash $1,870,535 $1,870,535 $415,674
Essex distribution (39,971) (39,971) (8,882)
Essex partnership 20,377 20,377 4,528
Sherwood partnership 1 1 1
Receivable 148 148 148
Consent dividend 105,202
--- --- ---
Total 1984 additions 1,851,091 1,956,294 411,470
Paid in capital

Beginning year 7,398 7,398 7,398
---------- ---------- ---------
End year 1,858,489 1,963,691 418,868

4. Flow of Payments by the Five 1985 Through 1989
After IRA transferred money from the Five to Carlco, TMT, and BWK in 1984, the structure in which payments were received from the Five changed. The payments from Essex and Hyatt (through KWJ Partnership) were no longer reported as IRA's income. Carlco, TMT, and BWK became partners of the Essex partnership and formed the KWJ Co. partnership. Hyatt payments were reported as income of KWJ Co. partnership. Accordingly, the payments from the Essex and KWJ Co. partnerships were reported on the respective returns of Carlco, TMT, and BWK at that time, and Carlco, TMT, and BWK were no longer members of the consolidated group of IRA for tax purposes.
a. Zeus 1984 Through 1988
IRA's consolidated returns for 1984 through 1988 reported the following income, net assets, and stockholder equity with respect to Zeus:

1984 1985 1986 1987 1988
--------- --------- --------- --------- ---------

Income
Interest $4,191 $13,639 $6,586 $684 $3,090
Commission 103,500 128,763 -- -- --
Partnership (203,947) (198,310) -- (31,204) (166,802)
--------- --------- --------- --------- ---------
Total Income (96,256) (55,908) 6,586 (30,520) (163,712)
Deductions (217) (727) (4,600) (105) (275)
--------- --------- --------- --------- ---------
Net income (96,473) (56,635) 1,986 (30,625) (163,987)
NOL -- (96,473) (153,108) (151,122) (181,747)
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Taxable (96,473) (153,108) (151,122) (181,747) (345,734)

Assets
Cash 219 855 3,971 3,866 3,591
Loan rec. 871,028 871,028 871,028 871,028 871,028
Partnerships (224,822) (424,040) (424,040) (454,560) (618,272)
Pooled funds 110,091 251,130 -- -- --
Non-mar. sec -- -- 250,000 250,000 250,000
--------- --------- --------- --------- ---------
Total 756,516 698,973 700,959 670,334 506,347
Liabilities -- -- -- -- --
--------- --------- --------- --------- ---------
Net assets 756,516 698,973 700,959 670,334 506,347

Capital stock 100 100 100 100 100
Capital surplus 49,900 49,900 49,900 49,900 49,900
Retained earn. 706,516 648,973 650,959 620,334 456,347

The Frey corporation paid Zeus $103,500 in 1984 and $128,763 in 1985 (totaling $232,263). During 1984, Zeus transferred $5,028 to Holding Co. The transfer increased the Holding Co. receivable from $802,000 owed by Holding Co. at the beginning of the year to $807,028 owed at the end of the year. During 1986, Zeus purchased 25 shares of preferred stock in another Kanter entity called Windy City, Inc. for $250,000. During 1988, Zeus eliminated the HELO receivable in exchange for the following receivables owed to HELO by the parties indicated:

APS Insurance $4,570
Beach Trust 17,651
R Trust 10,000
Softy Trusts 10,600
Grasshopper Trust 16,250
Pamela Osowski 4,929

Total 64,000

Zeus never accrued any interest or received any payments on any of those receivables or the receivables from Holding Co. and HELO.

b. Distributions of Schnitzer-PMS and Essex Payments Made During 1985 Through 1989

During 1985, IRA received funds from Schnitzer-PMS and Essex and made distributions to Carlco, TMT, and BWK, Inc. as follows:

1985 Receipts Distributions
----- -------- ------------

01/15 Qrtly payment $90,423
01/21 Carlco $40,500
TMT 40,500
BWK, Inc. 9,000
Essex-Blng to TMT, etc. 41,800
01/30 Pymt on amts owed re Essex 18,450
18,450
4,100
04/08 Schnitzer Corp./qrtly inst/int balloon 90,423
04/16 Carlco 40,500
TMT 40,500
BWK, Inc. 9,000
04/18 Essex 1st quarter dist. 13,063
04/25 Carlco 5,850
TMT 5,850
BWK, Inc. 1,300
07/03 Schnitzer Corp. qrt. pmt.($10,000 int BA) 90,423
07/08 Essex 2d quarter dist. 36,575
07/11 Carlco 16,200
TMT 16,200
BWK, Inc. 3,600
10/03 Essex 3d quarter 28,738
10/04 Schnitzer Corp.3d quarter 90,423
10/15 Carlco 81,000
TMT 81,000

BWK, Inc. 18,000

IRA recorded the 1985 payments to Carlco ($184,050), TMT ($184,050), and BWK, Inc. ($40,900) as follows (balance differences are due to rounding):

Item Carlco TMT BWK, Inc.
---------- ---------- ---------- ---------

Note to
Beginning -- -- --
07/11 additional $16,200 $16,200 $3,600
04/18 Essex (5,878) (5,878) (1,306)
07/08 Essex (16,459) (16,459) (3,658)
10/03 Essex (12,931) (12,931) (2,874)
12/31 Rec to proper account (16,200) (16,200) (3,600)
12/31 To combine same acct (360) (360) (80)
Ending (35,629) (35,629) (7,917)

Notes payable
Beginning -- -- --
01/13 Pymt on amts owed re Essex 18,450 18,450 4,100
01/21 FM Essex--blngs to TMT etc (18,810) (18,810) (4,180)
12/31 To combine same account 360 360 80
Ending -- -- --

Investment in stock
Beginning 1,856,942 1,962,144 417,321
01/21 additional capital 40,500 40,500 9,000
04/16 additional capital 40,500 40,500 9,000
04/25 additional capital 5,850 5,850 1,300
10/14 additional capital 81,000 81,000 18,000
12/31 R/C to proper account 16,200 16,200 3,600
To record consent dividend 97,206
Ending 2,040,992 2,243,400 458,221

1986

The record does not contain detailed general ledgers for IRA after 1985. The record indicates, however, that IRA recorded the 1986 payments from Schnitzer-PMS and Essex and distributions to Carlco, TMT, and BWK, Inc. as follows:

Item	Carlco	TMT	BWK, Inc.
Note to			
Beginning	($35,629)	($35,629)	($7,917)
Pd 2/86	35,629	35,629	7,917
Ending	-0-	-0-	-0-

Investment in stock			
Beginning	2,040,992	2,243,400	458,221
Ending	2,203,362	2,488,403	494,303
Contri. consent dividend		82,633	
Cash additions	162,370	162,370	36,082

1987

IRA recorded the 1987 payments from Schnitzer-PMS and Essex and distributions to Carlco, TMT, and BWK, Inc. as follows:

Item	Carlco	TMT	BWK, Inc.
Note to			
Beginning	--	--	--
08/06/87 Essex 2d quarter	($29,626)	($29,626)	($6,584)
10/08/87 Distr. Essex	29,626	29,626	6,584
12/10/87 Essex 3d quarter	(8,229)	(8,229)	(1,829)
12/15/88 Distr. Essex	8,229	8,229	1,829
Ending	--	--	--

Investment in stock			
Beginning	2,203,362	2,488,403	494,303

Additions			
01/14/87	40,690	40,690	9,042
05/07/87	40,690	40,690	9,042
09/10/87	40,690	40,690	9,042
10/19/87	40,690	40,690	9,043
12/11/87	29,553	29,553	
Total cash contrib.	192,313	192,313	36,169
12/31/87 consent div.		31,960	
Ending	2,395,676	2,712,677	530,473

1988

IRA recorded the 1988 payments from Schnitzer-PMS and Essex and distributions to Carlco, TMT, and BWK, Inc. as follows:

Item	Carlco	TMT	BWK, Inc.
Investment in stock			
Beginning	$2,395,676	$2,712,677	$530,473
Additions			
02/03/88	40,690	40,690	9,042
05/12/88	40,690	40,690	9,042
08/05/88	40,690	40,690	9,042
12/13/88	40,690	40,690	9,043
Total	162,761	162,761	36,169
2/31/88 consent div.		65,093	
Ending	2,558,437	2,940,531	566,642

1989

IRA recorded the 1989 payments from Schnitzer-PMS and Essex and distributions to Carlco, TMT, and BWK, Inc. as follows:

Item	Carlco	TMT	BWK, Inc.
Note receivable from			
Beginning	--	--	--

09/14/89 loan $55,000 $35,000 --
09/18/89 void check (55,000) (35,000) --
09/18/89 loan 117,000 44,000 --
12/04/89 loan 5,355 10,274 --
--- ---
Ending 122,355 54,274 --

Notes payable to
Beginning -- -- --
01/11/89 Essex 4th quarter dist. (20,573) (20,573) ($4,572)
01/11/89 Dist. 20,573 20,573 4,572
01/18/89 Dist. 20,573 20,573 --
01/18/89 void check (20,573) (20,573) --
07/26/89 Essex 1 & 2 quarter dist. (15,048) (15,048) (3,344)
08/02/89 Dist. 15,048 14,048 3,344
08/23/89 Essex dist. (8,229) (8,229) (1,829)
08/28/89 Dist. 8,229 8,229 1,829
Ending -- -- --

Investment in stock
Beginning 2,558,437 2,940,531 566,642
Additions
03/20/89 378,190 378,190 84,042
Rcls amended consent dividend from TMT (179,686)
1986-1988
Ending 2,936,627 3,139,035 650,684

c. Loans From IRA to KWJ Partnership Through 1989
In addition to payments made to Carlco, TMT, and BWK, Inc., that were treated as additions to capital, IRA made distributions recorded as loans to KWJ partnership as follows:

Receivable 1985 1986 1987 1988 1989
--- --- --- --- --- ---
Beginning year $30,000 $75,500 $113,500 $161,500 $181,500
Loans during year 45,500 38,000 48,000 20,000 68,370

End year 75,500 113,500 161,500 181,500 249,870

d. Balance Sheets of Carlco, TMT, and BWK, Inc.1983 Through 1989
The balance sheets for Carlco, TMT, and BWK, Inc. for the years 1983 through 1989 were as follows:

[Note: The following TABLE/FORM is too wide to be displayed on one screen.
You must print it for a meaningful review of its contents. The table has been
divided into multiple pieces with each piece containing information to help you
assemble a printout of the table. The information for each piece includes: (1)
a three line message preceding the tabular data showing by line # and
character # the position of the upper left-hand corner of the piece and the
position of the piece within the entire table; and (2) a numeric scale
following the tabular data displaying the character positions.]
****
****
******** This is piece 1. -- It begins at character 1 of table line 1. ********
****
****
Carlco 1983 1984 1985 1 986 1987
--- --- --- --- --- ---

Assets $7,500 $1,967,188 $2,327,066 $2,699,998 $3,078,545
Liabilities 4,000 4,000
Net assets 7,500 1,967,188 2,323,066 2,699,998 3,074,545

Cap. stock

Common 100 100 100 100 100
Preferred 2 3 3 3 3
Capital 7,398 1,858,489 2,042,539 2,168,127 2,397,222
surplus
Retained 108,596 280,424 531,768 677, 220
earnings
Total equity 7,500 1,967,188 2,323,066 2,699,99 8 3,074,545

Increase in 1,851,091 184,050 125,588 229,095
surplus
1...+...10....+...20....+...30....+...40....+...50....+...60....+...70
****
****
******* This is piece 2. -- It begins at character 71 of table line 1. ********
****
****
1988 1989
--------- ---------

$3,728,530 $4,404,569
122,355
3,728,530 4,282,214

100 100
3 3
2,559,983 2,938,173

1,168,444 1,343,938

3,728,530 4,282,214

162,761 378,190

71..+...80....+...90...

[Note: The following TABLE/FORM is too wide to be displayed on one screen.
You must print it for a meaningful review of its contents. The table has been
divided into multiple pieces with each piece containing information to help you
assemble a printout of the table. The information for each piece includes: (1)
a three line message preceding the tabular data showing by line # and
character # the position of the upper left-hand corner of the piece and the
position of the piece within the entire table; and (2) a numeric scale
following the tabular data displaying the character positions.]
****
****
******** This is piece 1. -- It begins at character 1 of table line 1. ********
****
****
TMT 1983 1984 1985 1986 1987
---------- ------ --------- --------- --------- ---------

Assets $7,500 $2,015,911 $2,293,151 $2,518,717 $2,735,965
Liabilities 4,000
Net assets 7,500 2,015,911 2,289,151 2,518,717 2,735,965

Cap. stock
Common 100 100 100 100 100
Preferred 2 3 3 3 3
Capital 7,398 1,963,692 2,244,947 2,489,950 2,714,224
surplus
Retained 52,116 44,101 28,664 21,638
earnings

Total equity 7,500 2,015,911 2,289,151 2,518,71 7 2,735,965

Increase in 1,956,294 281,255 245,003 224,274
surplus

Book income 157,318
Consent 105,202 97,206 82,633 31,960
dividend
Retained 52,116
earnings

Surplus 1,956,294 281,255 245,003 224,274
increase
Consent 105,202 97,206 82,633 31,960
dividend
--------- --------- --------- ---------
Difference 1,851,092 184,049 162,370 192,314
FN* Reverse 86, 87 & 88 consent dividend paid to IRA.
1...+...10....+...20....+...30....+...40....+...50....+...60....+...70
****
****
******* This is piece 2. -- It begins at character 71 of table line 1. ********
****
****
1988 1989
--------- ---------

$3,215,925 $3,880,997
54,274
3,215,925 3,826,723

100 100
3 3
2,942,077 3,140,582

273,745 686,038

3,215,925 3,826,723

227,853 198,505

65,093 -0-

227,853 37 8,190

65,093 *179,786

--------- ---------
--------- ---------
162,760 198,404

71..+...80....+...90...

BWK, Inc. 1983 1984 1985 1986 1987 1988 1989
---------- ------ -------- -------- -------- --------- -------- --------

Assets $7,500 418,558 406,909 388,362 395,808 451,711 515,772
Liabilities 7,534 1,000 286 8,000 -0- 2,253
Net assets 7,500 411,024 405,909 388,076 387,808 451,711
513,519

Cap. stock
Common 100 100 100 100 100 100 100
Preferred 2 3 3 3 3 3 3
Capital 7,398 418,868 459,768 495,869 532,038 568,207 652,250
surplus
Retained (7,947) (53,962) (107,896) (144,333) (116,599)

(138,834)
earnings
Total equity 7,500 411,024 405,909 388,07 6 387,808 451,711
513,519

Incrẽase in 411,470 40,900 36,10 1 36,169 36,169 84,043
surplus

B. Flow of the Funds Paid By the Five Through IRA and Its Subsidiaries to Kanter, Ballard, and Lisle

1. Overview

The payments from the Prudential transactions were distributed by various means either directly to Ballard, Lisle, and Kanter or indirectly through their family members or trusts and other entities established for the benefit of their families. Some distributions were recorded as receivables owed by the person or entity receiving the distribution; others were recorded as consulting fees or director's fees. Distributions from KWJ Corp. and later KWJ partnership to Ballard's and Lisle's children were treated as consulting fees. In 1983, IRA began distributing the funds accumulated from the Prudential transactions to Carlco, TMT, and BWK, Inc. Lisle was given control over the funds in Carlco, Ballard was given control over the funds in TMT, and Kanter was given control over the funds in BWK, Inc. Lisle, Ballard, and Kanter treated the funds as their own and used the funds for their personal benefit.

2. Payments from IRA, KWJ Corp., and KWJ Co. Partnership

a. 1982: IRA Payments to Ballard and Lisle

In 1982, Ballard received $12,500 from IRA as a "director's fee". The check was dated in 1981 but cashed in 1982. On March 2, 1982, IRA paid Lisle $1,157.84.

b. Consulting Fees Paid to Ballard's and Lisle's Children

Melinda Ballard and Karen Ballard Hart were Ballard's daughters. Amy Albrecht was Lisle's daughter, and Thomas Lisle was Lisle's son. In 1982, KWJ Corp. (and later the KWJ partnership) began paying Thomas Lisle, Amy Albrecht, and

Melinda Ballard $1,000 each per month. [FN30] In 1984, the KWJ partnership began paying Karen Hart $1,000 each month. The payments continued until at least 1989. From 1982, KWJ Corp. and the KWJ partnership paid the Lisle and Ballard children the following amounts as consulting fees: [FN31]

	Lisle Children		Ballard Children	
Year	Thomas Lisle	Amy Albrecht	Melinda Ballard	Karen Hart
1982	$7,000	$7,000	$7,000	--
1983	12,000	12,000	12,000	--
1984	12,000	12,000	12,000	$2,000
1985	12,000	11,000	12,000	12,000
1986	12,000	13,000	12,000	12,000
1987	12,000	12,000	12,000	12,000
1988	12,000	12,000	12,000	12,000

During 1989, KWJ partnership paid the Lisle and the Ballard children $36,000. Of the $36,000 paid, Lisle's children received at least $18,000 and Ballard's children received at least $12,000. [FN32]

None of the Ballard or the Lisle children performed any services for KWJ Corp. or KWJ partnership. The Hyatt payments and interest were the only sources of income KWJ Corp. or KWJ partnership ever received.

In February 1990, after the Internal Revenue Service began examining Ballard's, Kanter's, and Lisle's returns for the years at issue, Kanter sent letters to the children terminating KWJ Co's. "consulting arrangement" with them. In the letters Kanter stated that the children had done nothing for a number of years.

c. KWJ Partnership 1989 Payments to Lisle and Ballard

As noted earlier, Carlco, TMT, and BWK, Inc., organized the KWJ Partnership. The Hyatt payments were issued by Hyatt

to Weaver who forwarded the payments to the KWJ Partnership, out of which Weaver was paid his 30 percent and the balance was distributed to Carlco, TMT, and BWK, Inc.

On August 2, 1989, IRA issued checks in the amount of $22,618.80 each to Ballard and Lisle. After the checks were issued to Ballard and Lisle, IRA records reflected a transfer of $45,237 to "KWJ Company" on August 8, 1989. Also on August 8, 1989, ledger entries reflected that the check to Lisle for $22,618.80 was "void". Another ledger entry, on August 15, 1989, reflected that the check to Ballard for $22,618.80 was "void". Despite the fact that IRA's ledger entries stated that these checks were void, Lisle's 1989 return reflected that he received this money and that the check was not "voided." Lisle reported the $22,619 on his return as income from the "KJW [sic] Company."

3. Disposition of Funds out of Carlco, TMT, and BWK to Kanter

a. Creation of Carlco, TMT, and BWK, Inc.

The certificates of incorporation of Carlco, TMT, and BWK, Inc., authorized each corporation to issue 1,000 shares of 10-cent par value common stock. Certificates of amendment for each corporation were filed in December 1983. The amended certificates authorized the corporations to issue 11,000 shares of stock comprised of 10,000 shares of 1-cent par value preferred stock and 1,000 shares of 10-cent par value common stock. The amended certificates granted each corporation's board of directors authority to fix the dividend rights, dividend rate, conversion rights, voting rights, the rights and terms of redemption (including sinking fund provisions), the redemption price or prices, and the liquidations preferences of the preferred shares. The record does not contain copies of any resolutions by the board of directors of any of the three corporations setting preferences or limitations on the preferred stock.

Kanter was a beneficiary of a trust called the Morkan Trust. [FN33] On October 17, 1983, Kanter exercised a power of appointment over the Morkan Trust to form the Christie and

Orient Trusts. Sharon Meyers was named as trustee of the Christie and Orient Trusts. Members of Lisle's family were named as beneficiaries of the Christie Trust, and members of Ballard's family were named as beneficiaries of the Orient Trust.

In December 1983, IRA acquired 1,000 shares (100 percent) of the common stock of each of Carlco, Inc. (Carlco), TMT, Inc. (TMT), and BWK, Inc. (BWK). IRA paid $6,000 to each of the corporations for the shares of stock. Also in December 1983, Carlco, TMT, and BWK each issued 150 shares of preferred stock for $1,500. Carlco preferred shares were issued to the Christie Trust (Lisle's family trust); TMT preferred shares were issued to the Orient Trust (Ballard's family trust); BWK preferred shares were issued to the BK Children's Trust, the beneficiaries of which were members of Kanter's family.

In January 1984, Carlco, TMT, and BWK each issued 150 additional shares of preferred stock for $150. Carlco issued the additional preferred shares to the Christie Trust, TMT issued the additional preferred shares to the Orient Trust, and BWK issued the additional preferred shares to the BK Children's Trust. As a result of those trusts' ownership of these preferred shares, Carlco, TMT, and BWK, Inc., no longer qualified as members of IRA's consolidated group of corporations and were not included in the consolidated tax returns IRA filed.

b. Control and Management of Carlco, TMT, and BWK, Inc.

Kanter directed Freeman (IRA's president) to distribute funds received by IRA related to Prudential transactions in the ratio of 45 percent to Carlco, 45 percent to TMT, and 10 percent to BWK. From 1984 through 1989, IRA generally transferred funds and other assets to Carlco, TMT, and BWK, Inc., in the respective 45-45-10 allocation ratio Kanter had directed.

Lisle managed and controlled Carlco's investments. Lisle and members of his family, including his wife Donna Lisle and his son Thomas Lisle, had signatory authority over Carlco's accounts. In 1982 Kanter, his brother Carl Kanter,

and Meyers were the officers and/or directors of Carlco. In 1983, Meyers and Freeman were the directors, president, and treasurer, and Gallenberger was secretary. From 1984 through 1989, there were no directors listed; Lisle, his brother Henry Lisle, his son Thomas Lisle, and his wife Donna Lisle served as president or vice president, D. Dubanevich was secretary; and, except for 1985, [FN34] Meyers or Gallenberger was treasurer.

Ballard managed and controlled TMT's investments. Ballard and members of his family, including his wife Mary Ballard, had signatory authority over TMT's accounts. In 1982, Kanter, his son Joshua, and Meyers were the directors of TMT, Kanter was president, his son Joshua was treasurer, and Meyers was vice president and secretary. Between 1983 and 1989, Freeman, Meyers, and/or Gallenberger were the directors and officers.

Kanter managed and controlled BWK, Inc.'s investments. In 1982, Kanter, his son Joshua, and Meyers were the directors and officers of BWK, Inc. From 1983 through 1989, Weisgal was the sole director and president, Kanter, Meyers, and/or Gallenberger were the remaining officers. [FN35] In 1990, Kanter was the sole director and president, and Gallenberger was secretary.

After Carlco, TMT, and BWK, Inc., were organized, the payments by the Five were distributed to Carlco, TMT, and BWK, Inc.

c. Ballard: Disposition of Funds out of TMT

During the years 1982 through 1989, the following individuals were listed as the "officers" and "directors" of TMT:

Title 1982 1983 1984
---------- -------- -------- --------
Directors Kanter Freeman Freeman
Joshua Kanter Meyers Meyers
Meyers
President Kanter Meyers Meyers
Vice president Meyers

Vice president Meyers
Secretary Meyers Gallenberger Gallenberger
Treasurer Joshua Kanter Meyers Meyers
Assistants Joshua Kanter

Title 1985 1986 1987
---------- ---------- ---------- ----------
Directors Meyers Gallenberger Gallenberger
President Meyers Gallenberger Gallenberger
Vice president
Secretary Gallenberger Gallenberger Gallenberger
Treasurer Meyers Gallenberger Gallenberger
Assistants

Title 1988 1989
---------- ---------- ----------
Directors Gallenberger Gallenberger
President Gallenberger Gallenberger
Vice president
Secretary Gallenberger Gallenberger
Treasurer
Assistants

The records for TMT were maintained at Ballard's home. TMT's business address was the same as Ballard's residence in Seabright, New Jersey. Mail for TMT was received at Ballard's home. Correspondence from TMT was sent from Ballard's home address.

i. TMT Accounts

During 1984, IRA transferred over $1 million to TMT. The money generally was deposited into TMT's account with the Administration Co., and certificates of deposit (CD's) were purchased through Administration Co.'s account at the American National Bank in Chicago.

At the end of 1984, the money designated for TMT in CD's at the American National Bank in Chicago, purchased through the Administration Co. account, totaled $1,604,000. By the

end of the year 1985, no money designated for TMT was in CD's at the American National Bank in Chicago. The money that had been in CD's at the American National Bank in Chicago was transferred into CD's at the Wells Fargo Bank in San Francisco. By the end of the year 1985, the amount of money in CD's at the Wells Fargo Bank San Francisco totaled $1,874,295.

During the years 1984 through 1989, moneys other than CD's for TMT were deposited in an account maintained at the Wells Fargo Bank, in San Francisco, account No. 170-752. The mailing address of this account was 65 Island View Townhouses, Seabright, New Jersey, which was the Ballard residence address. Ballard opened this account in the name of "TMT", and he and his wife had signatory authority over it. The money in this account at the end of the years 1984 through 1989 was as follows:

Year	Wells Fargo
1984	--
1985	$8,768
1986	19,438
1987	157,489
1988	192,915
1989	141,968

By the end of the year 1986, the amount of money in CD's at the Wells Fargo Bank decreased to zero. Of the money that had been in CD's, $1,205,900 had been transferred to a Goldman Sachs brokerage account. The money in the Goldman Sachs brokerage account at the end of the years 1987 through 1989 was as follows:

Year	Goldman Sachs
1987	$53,803
1988	75,460

1989	155,300

During the years 1986 through 1989, moneys for TMT were deposited in an account maintained at the Citizen Bank. The balance in this account at the end of the years 1986 through 1989 was as follows:

Year	Citizen Bank
1986	$25,248
1987	26,600
1988	1,929
1989	2,023

TMT also had a money market account (Kemper Money Market account). At the end of the year 1989, there was a balance of $349,182 in the Kemper Money Market account.

ii. "Loans" From TMT

In 1984 receivables owed by Ballard's Seabright Trust and Seabright Corp. respectively in the amounts of $12,255 and $31,440 were transferred from Administration Co. to TMT. From 1984 through 1989, the Seabright Trust and Seabright Corp. received additional "loans" totaling $132,980 from TMT. The balances on these loans at the end of each year were as follows:

Year	Seabright Trust	Seabright Increase	Corp.	Increase
Trans. from Special E	$12,255	--	$31,440	--
1984	53,055	$40,800	31,440	--
1985	79,155	26,100	31,520	$80
1986	100,155	21,000	36,520	5,000
1987	100,155	--	41,520	5,000
1988	135,155	35,000	41,520	--
1989	135,155	--	41,520	--

Total 122,900 10,080

There were no notes in connection with the "loans" to the Seabright Trust or the Seabright Corp. There is no evidence that either the Seabright Trust or Seabright Corporation paid interest on the "loans" from TMT. The loans were never repaid.
From 1984 through 1989, Claude Ballard and Mary Ballard received a total of $303,943 from TMT as "loans". The balances due on these loans at the end of each year were as follows:

Year	Claude Ballard	Mary Ballard
1984	$10,599	--
1985	10,599	$160,000
1986	16,599	160,000
1987	36,943	160,000
1988	136,943	160,000
1989	146,943	160,000

With respect to the $160,000 "loan" to Mary Ballard, during 1985, a document dated December 26, 1986, purported to provide for the repayment of this "loan" with Macy's stock held privately by Ballard. The records of TMT do not indicate that the $160,000 "loan" was repaid. The records of TMT do not indicate that the Macy's stock was given to TMT in accordance with the December 26, 1986, document.
In 1986, $100,000 of TMT funds were used to purchase land described in the TMT general Ledger as "St. Francis Arkansas--Land ." The cost of this land was $100,000. In 1987, this property was transferred to Ballard. Book entries were made to reflect this transaction. "Loans" to Ballard were increased by $100,000. The land was no longer reflected as a TMT asset. The adjusting journal entry that went with the transfer to Ballard described the property as the "Fairfield Planting Company". This "loan" has never been repaid. In

1987, TMT paid an additional $20,344 for the Fairfield property, which amount was treated as an additional loan to Ballard.
The Fairfield Planting Co. is an S corporation which owned the Fairfield Plantation, a farm in Arkansas. The income and loss from the Fairfield Plantation Co. were reported on Ballard's 1987, 1988, and 1989 returns.
At the time of trial of these cases, TMT owned the following farms or other entities: Ashland Plantation in Mississippi, Fairfield in Arkansas, and Loch Leven in Mississippi. The Ballards referred to the Loch Leven farm as "our big farm." According to Mary Ballard, TMT, at one time, had been involved with Lock Leven, but it was owned by the Ballards. Mrs. Ballard did not know who owned the stock of TMT. She referred to TMT as her husband's business.
Ficom was a sole proprietorship formed by Ballard's daughter Melinda Ballard in 1983. In 1986, $4,000 from TMT was transferred to Ficom. In 1988, TMT transferred another $15,000 to Ficom. When the transfer was made, a bookkeeping notation was also made to write off the investment in 1989. The investment in Ficom was subsequently written off as worthless in 1989.
d. Lisle: Disposition of Funds out of Carlco
During the years 1982 through 1989, the following individuals were listed as the "officers" and "directors" of Carlco:

Title	1982	1983	1984
Directors	Kanter	Freeman	(deleted)
	Carl Kanter	Meyers	
President	Carl Kanter	Meyers	Henry Lisle
Vice president	Kanter	_____	Donna Lisle
Secretary	Meyers	Gallenberger	D. Dubanevich
Treasurer	Meyers	Meyers	Meyers

Title	1985	1986	1987

Directors	None	None	None
President	Henry Lisle	Henry Lisle	Henry Lisle
Vice president	Donna Lisle	Donna Lisle	Donna Lisle
Secretary	Dubanevich	Dubanevich	Dubanevich
Treasurer	_____	Gallenberger	Gallenberger
Assistants	Meyers	Lisle	Lisle

Title	1988	1989
Directors	None	None
President	Henry Lisle	Robert Lisle
Vice president	Donna Lisle	Thomas Lisle
Secretary	Dubanevich	Donna Lisle
Treasurer	Gallenberger	Gallenberger

During the years 1984 through 1989, moneys from Carlco were deposited in a brokerage account maintained at Goldman Sachs (Carlco Goldman Sachs account). The mailing address of the Carlco Goldman Sachs account was in care of Robert Lisle, 47 Cheltenham Way, Avon, Connecticut, which was the address of the Lisle family residence. Lisle, Mrs. Lisle, and Henry Lisle (Lisle's brother) had signatory authority over this account. The balance in this account at the end of 1984 to 1988 was as follows:

Year	Goldman Sachs
1984	$113,255
1985	42,362
1986	90,601
1987	70,372
1988	392,252
1989	82,559

During the years 1984 through 1989, other money from Carlco was deposited into an account in the name of Carlco

at the Hartford Bank in Connecticut (Hartford account). The mailing address of the Hartford account was in care of Lisle at the Lisle family residence. Lisle and his wife had signatory authority over the account. The balance in the account at the end of the years 1984 through 1988 was as follows:

Year	Hartford
1984	$18,198
1985	10,871
1986	211,618
1987	161,573
1988	153,767

On April 12, 1985, Lisle withdrew $3,000 from Carlco's Hartford account to pay a receivable owed to Administration Co. by his grantor trust, the RWL Cinema Trust. The payment did not create a receivable owed to Carlco by RWL Cinema Trust.

Around 1989, the Lisles moved to Dallas, Texas. During the year 1989, money from Carlco was deposited in an account maintained at the North Dallas Bank, Dallas, Texas (North Dallas account). The mailing address of the North Dallas account was 5519 Bent Trial, Dallas, Texas, which was the address of the Lisles' Dallas residence. Lisle and his wife had signatory authority over the North Dallas account. At the end of 1989 there was $123,323 in the account.

e. Kanter: Disposition of Funds out of BWK, Inc.

During the years 1984 through 1989, Kanter and his son, Joshua Kanter, received a "salary" from BWK, Inc., in the amounts indicated:

Year	Burton Kanter	Joshua Kanter
1984	$40,000	–
1985	40,000	$9,000
1986	40,000	13,000

1987 30,000 4,000
1988 30,000 --
1989 30,000 --
---------- ----------
Total 210,000 26,000

On April 11, 1985, $400,000 was transferred from BWK, Inc. to Kanter. The transfer was recorded on BWK, Inc.'s books as a receivable owed by Kanter. Beginning in 1988, although book entries continued to show that BWK, Inc., paid Kanter a $30,000 salary, Kanter did not receive the money. Instead, BWK, Inc., reduced the $400,000 receivable from Kanter by $30,000 per year.

4. Loans

a. IRA Loans to Kanter

IRA's records reflect the following amounts transferred to Kanter and recorded as receivables:

Burton W. Kanter

1982 Beginning balance --
Adj for bal in Cedilla Trust $4,450
Ending balance 4,450

1983 Beginning balance 4,450
Loan repymt. from BWK --
Ending balance

1984 No entry

1985 Beg. balance --
Sold Geochem to BWK 500
Sell TWOOD rec to BWK 10,000
Sold funds for Energy 5,000
Rec sale of assets sold 1,110
Ending balance 16,610

1986 Unexplained acct. total (39,940)

1987 Beg. balance (39,940)
Repay BWK RE H BLUM 219
HB Rpymt (S/B to BWK) (219)
Move to notes payable 39,940
Ending balance --

1988 No entry

1989 Beg. balance --
B. Kanter/Ln 250,000
Unavailable history 350,000
Ending balance 600,000

b. Loans to Ballard, Lisle, Their Family Members and Trusts

Ballard and Lisle established the following grantor trusts, the income (or losses) of which was includable in Ballard's and Lisle's income pursuant to sections 671 through 678:

Date Established Ballard Lisle
---------- ---------- ----------

10/23/73 CMB Cinema Trust [FN36] RWL Cinema Trust
7/15/75 CMB Cinema Trust II RWL Cinema Trust II
6/03/80 Summit Trust Basking Ridge Trust
11/02/81 Seabright Trust

Mrs. Lisle and/or Lisle's children or descendants were the beneficiaries of Lisle's grantor trusts, and Kanter and/or Weisgal were the trustees. Mrs. Ballard and/or Ballard's children were the beneficiaries of Ballard's grantor trusts, and Kanter and/or Weisgal were the trustees.

The CMB Cinema Trust and CMB Cinema Trust II, RWL Cinema Trust, and RWL Cinema Trust II (hereinafter collectively referred to as the Cinema trusts) each made

investments, as limited partners, in certain movie shelter partnerships. Each trust financed the acquisition of its movie partnership interest through loans from IRA and Int'l Films. The Seabright Corp. was owned by the Mary Family Trust. The Seabright Corp. owned a farm called Seabright Farm located near Little Rock, Arkansas. The beneficiaries of the Mary Family Trust were Mary Ballard and her three daughters. The records of the Seabright Corp. were maintained at Ballard's residence. Mary Ballard was an officer of the Seabright Corp.

On May 29, 1976, the CMB Cinema Venture partnership was formed. The CMB Cinema Trust and the CMB Cinema Trust II were partners in the CMB Cinema Venture partnership. As of the end of 1987, CMB Cinema Venture partnership was a shareholder of Int'l Films.

The movie ventures in which the trusts invested proved unsuccessful and were not profitable. Substantial losses from the ventures were reported by Ballard on his income tax returns. The Internal Revenue Service later disallowed the deductions that Ballard claimed on his tax returns with respect to these movie investments. As a result, the Ballards were required to pay additional taxes. In July 1985, Mrs. Ballard borrowed $160,000 from TMT to pay this income tax liability.

Kanter entities made the following loans to Ballard, his family members, and entities established for the benefit of his family members:

Ballard Loans

Lender Year Distributee Amount

Int'l Films 1974 CMB Cinema Trust $10,000
Int'l Films 1975 CMB Cinema Trust 21,500
Int'l Films 1975 CMB Cinema Trust II 12,500

Int'l Films 1976 CMB Cinema Trust 8,200
Int'l Films 1976 CMB Cinema Trust 19,000
Int'l Films 1976 CMB Cinema Trust II 1,100
Int'l Films 1977 CMB Cinema Trust 2,200
Int'l Films 1977 CMB Cinema Trust II 3,400
Int'l Films 1978 CMB Cinema Trust 3,000
Int'l Films 1978 Ballard 9,500
Int'l Films 1979 Ballard 8,784
HELO 1980 Summit Trust 85,000
HELO 1981 Summit Trust 20,700
Int'l Films 1981 CMB Cinema Trust 4,000
IRA 1982 Ballard 160,400
IRA 1983 Ballard 500
Administration Co. 1983 Seabright Trust 11,300
Administration Co. 1984 Ballard 10,000
Administration Co. 1984 Seabright Corp. 25,840
TMT 1985 Mary Ballard 160,000
Administration Co. 1988 Seabright Corp. 5,000

Kanter entities made the following loans to Lisle, his family members, and entities established for the benefit of his family members:

Lisle Loans

Lender Year Distributee Amount

Int'l Films 1974 RWL Cinema Trust $15,000
Int'l Films 1975 RWL Cinema Trust II 20,000
Int'l Films 1975 Lisle 10,000
Int'l Films 1976 RWL Cinema Trust 5,000
Int'l Films 1976 RWL Cinema Trust II 18,000
Int'l Films 1977 RWL Cinema Trust II 5,000
Int'l Films 1978 Lisle 9,500
Int'l Films 1978 RWL Cinema Trust II 3,750

Int'l Films 1978 RWL Cinema Trust II 4,469
Int'l Films 1979 Lisle 8,784
Int'l Films 1979 RWL Cinema Trust II 3,000
Int'l Films 1980 RWL Cinema Trust II 250
Int'l Films 1981 RWL Cinema Trust II 2,750
Int'l Films 1982 RWL Cinema Trust II 2,320
Int'l Films 1983 RWL Cinema Trust II 3,000
HELO 1983 Basking Ridge Trust 95,000
IRA/Int'l Films 1983 Lisle 3,000
Int'l Films 1984 RWL Cinema Trust II 3,000
Administration Co. 1985 RWL Cinema Trust II 3,000
Int'l Films 1986 RWL Cinema Trust II 3,000
Administration Co. 1987 RWL Cinema Trust II 2,463
IRA 1988 RWL Cinema Trust II 6,000
BWK 1989 RWL Cinema Trust II 3,000
BWK 1990 RWL Cinema Trust II 2,969

5. Writeoff of Loans and Losses

Kanter traded receivables between various entities and used convoluted bookkeeping entries to eliminate the receivables and to create bad debt and worthless stock deductions.

IRA distributed $160,400 to Ballard in 1982 and $500 in 1983 and recorded the transfers as receivables owed by Ballard. IRA immediately transferred the receivables to Int'l Films. IRA's general ledgers reflected Ballard's receivable account for 1982 and 1983 as follows:

Claude Ballard

1982 Beg. balance
Record trns Dec 1982 $160,400
Asgn Ballard ln to IFI (160,400)
Ending balance -0-

1983 Beg. balance -0-
TACI E ln for C. Ballard 500

Asgn to IFI ck 1120 (500)
Ending balance -0-

IRA's general ledger showed Int'l Films' receivable for 1982 as follows:

Int'l Films

1982 Beg. balance $70,200
Int'l Films 13,000
Int'l Films 4,000
Int'l Films-loan 1,250
Trans. thru Nov. 1982 7,130
Trans. thru Dec. 1982 5,465
Ballard loan asgn to Int'l Films 160,400

Ending balance 261,445

By the end of 1982, IRA had transferred $1,189,900 to HELO that was recorded as a receivable owed to IRA by HELO. [FN37] In 1983 HELO had $95,000 receivables owed to it from Lisle's Basking Ridge Trust and $106,200 from Ballard's Summit Trust. [FN38]

In 1983, a transaction took place between IRA, the Bea Ritch Trusts, Int'l Films, and HELO which had the effect of (1) increasing the receivables due to IRA from the Bea Ritch Trusts by $500,000; (2) decreasing IRA's outstanding receivables due from HELO by $701,200; (3) eliminating HELO's $95,000 receivables from Lisle's Basking Ridge Trust and $106,200 from Ballard's Summit Trust; and (4) creating IRA receivables of $95,000 from the Basking Ridge Trusts and $106,200 from the Summit Trust. IRA's general ledger and adjusting journal entries reflected the effect of the transfers on receivables owed to it as follows:

HELO Receivables Owed to IRA

1983 Beginning balance $1,189,900
Loan repymt from HELO (11,200)
Part. loan repymt HELO (900)
Repayment frm HELO via BRT 1 (500,000)
Lns Bask Rg & Summit via HELO (201,200)
Ln fm FIN Acq. via HELO 33,500
Ending balance 510,100
FN1. No actual payment was made. Instead the receivable due from Bea Ritch
Trusts was increased by $500,000.

Summit Trust Receivables Owed to IRA

1983 Beg. balance -0-
Ln rpymt from Summit ($10,100)
Lns BSK RG & SMT via HELO 106,200
Asgn SMT & BSK RG to IFI (96,100)
Ending balance -0-

Basking Ridge Trust Receivables Owed to IRA

1983 Beg. balance -0-
Ln rpymt Frm Bask Rdg ($10,300)
Lns BSK RG & SMt via HELO 95,000
Asgn SMT & BSK RT to IFI (84,700)
Ending balance -0-

1983 AJE 9--To adj. for loans made to Basking Ridge & Summit via HELO (remove HELO from middle)

Debit Credit

------- --------
1191-0256 Due from Basking Ridge 95,000
1191-0255 Due from Summit 106,200
1191-032 Due to HELO (201,200)

1983 AJE 26 To record transfer of receivables from Basking Ridge & Summit to IFI on 10/31/83)

Debit Credit
------- --------
1191-0121 Due from IFI 180,800
1191-0255 Due from Summit (96,100)
1191-0256 Due from Basking Ridge (84,700)

Int'l Films Receivables Owed to IRA

1983 Beg. balance 261,445
Loan to Int'l Films 1,400
Loan to Int'l Films 1,000
IFloan on behalf of R Lisle 3,000
Loan to Int'l Films 100
Loan to Int'l Film 200
Loan to Int'l Film 100
Loan repymt from Int'l Films (1,000)
Loan repymt from Int'l Films (500)
Loan repymt from Int'l Films (325)
Loan repymt from Int'l Films (700)
Asgn. to Int'l Films 1 500
Asgn Summit and Basking Ridge Int'l Films 2 180,800
Asgn 1984 Devlp to Int'l Films 3 86,400

Acct. Total 532,420
FN1. Check # 1120--Administration Co. loan for C. Ballard $500.

FN2. 1983 AJE 26--to record transfer of receivables from Basking Ridge & Summit
to Int'l Films on 10/31/83.
FN3. 1983 AJE 28--to record assignment of interest in 1984 Development to Int'l
Films on 10/31/83.

In essence, IRA obtained HELO's receivable due from Basking Ridge and Summit. Simultaneously with this book entry transaction, IRA transferred to Int'l Films the $180,800 balance of the receivables due from Basking Ridge and Summit that it had just obtained from HELO and in exchange, IRA entered on its books a receivable due from Int'l Films for the amount of the Summit and Basking Ridge receivables, $180,800, $201,200 less a credit of $10,300 that was treated as a "loan repayment" from Basking Ridge, and $10,100 credit for a "loan repayment" from Summit. The sources of the credits are not shown in the record. In addition to the receivables, IRA transferred to Int'l Films its interest in a partnership called 1984 Development valued at $86,420.
In 1987, receivables were again reshuffled. On December 17, 1987, Int'l Films' records reflected receivables owing by Ballard, Lisle, and their trusts totaling $582,682, as shown here:

Int'l Films Receivables
Ballard $35,784
Ballard 160,900
CMB Cinema 70,650
CMB II 16,675
Summit 96,100
CMB Cinema Ventures 250

Subtotal 380,359
Lisle 28,284
RWL Cinema 21,500

RWL II 67,839
Basking Ridge 84,700

Subtotal 202,323
Total 582,682

On December 17, 1987, Int'l Films had additional receivables totaling $538,243 owing by the following entities in the amounts shown:

Entity/Individual Amount
Safari Trust $98,450
HGA Cinema 133,695
Elk Invest. 76,500
Inter Alia 125,000
Hargen 8,000
Holding Co. 29,500
Abernathy 67,098

Total 538,243

Although the record does not contain a complete history of the outstanding receivables, the record does disclose the following loans made by Int'l Films through April 1981:

Inter Alia Investments
10/26/73 $140,000
12/16/77 Principal payment (10,000)
B5 03/27/78 Principal payment (5,000)

Balance 125,000

Elk Investment
11/09/76 76,500

Claude M. Ballard
07/27/78 9,500

08/14/79 8,784

Balance 18,284

CMB Cinema Trust
10/29/74 10,000
12/23/75 21,500
04/12/76 8,200
05/27/76 19,000
12/16/77 2,200
11/01/78 3,000
04/81/81 4,000

Balance 67,900

CMB Cinema Trust II
09/29/75 12,500
08/25/76 1,100
12/16/77 3,400

Balance 17,000

Robert W. Lisle
10/31/75 10,000
07/27/78 9,500
03/14/79 8,784

Balance 28,284
RWL Cinema Trust
10/29/74 15,000
05/27/76 5,000

Balance 20,000

RWL Cinema Trust II
11/25/75 20,000
04/12/76 18,000

12/16/77 5,000
11/01/78 3,750
03/28/78 4,469
01/04/79 3,000
02/07/80 250
02/23/81 2,750

Balance 57,219

HGA Cinema Trust
12/23/75 52,200
04/12/76 17,000
05/27/76 37,125
03/14/79 5,000
11/08/79 3,500
01/08/80 100

Balance 114,925
Safari Trusts
12/23/75 33,800
06/15/76 64,000

Balance 97,800
Hargen

07/27/76 8,000

Harold G. Abernathy (stockholder)
05/10/74 45,000
09/11/74 20,000
01/06/75 40,000
Dividend
08/31/74 (11,238)
08/31/75 (7,878)
08/31/76 (18,786)

Balance 67,098

Although some of the receivables indicated an interest rate, there is no evidence that any interest was ever paid, and the outstanding balances were never increased to reflect accruing interest.
In 1987, IRA held 1,500 shares of stock in Int'l Films. IRA's basis in the Int'l Films stock was $65,000. Additionally, in 1987, IRA had a $507,648 receivable owing to it by Int'l Films.
Int'l Films' trial balance sheet for the taxable year ending 8/31/87 showed the following:

Assets

Receivables
Safari Trust $98,450
CMB Cinema Trust 70,650
CMB Cinema Trust II 16,675
RWL Cinema Trust 21,500
RWL Cinema Trust II 67,839
HGA Cinema Trust 133,695
Elk Investment 76,500
Inter Alia 125,000
Hargen 8,000
HELO 1 180,800
Ballard 35,784
Ballard II 160,900
Lisle 28,284
HGA Cinema Trust 67,098
CMB Cinema Venture 250
Holding Co. 29,500

Total receivables 1,120,925
Other assets
1984 Development Partnership 55,288
Other taxes 80

Total assets 1,176,293
Liabilities

Cash deficit 60
IRA 507,648
I & F Corp. 774

Total liabilities 508,482
Stockholder equity

Preferred 150
Common 606
Paid-in capital 655,889
Retained earnings 11,167

Total equity 667,812
FN1. Int'l Films received the HELO receivable in exchange for the Summit Trust
receivable of $96,100 and Basking Ridge Trust receivable of $84,700.

IRA advanced $60 to cover Int'l Films' cash deficit and increased the receivable owed by Int'l Films from $507,648 to $507,708. On December 17, 1987, IRA canceled the $507,708 receivable due from Int'l Films in exchange for (1) the interest in 1984 Development partnership valued at $55,288 [FN39] plus (2) $1,120,925 of receivables. IRA had transferred the interest in 1984 Development partnership to Int'l Films in 1983. Thus the notes and partnership interest that Int'l Films transferred to IRA constituted all of Int'l Films' assets.
IRA apportioned the $507,708 basis in the Int'l Films receivable among the receivables transferred to IRA from Int'l Films and the interest in the 1984 Development, Ltd., partnership interest as follows (balance differences are due to rounding):

Basis Weighted Basis Int'l Films Receivable Int'l Films Average IRA Writeo ff
Safari $98,450 8.37 $42,495 $55,955
CMB Cinema 70,650 6.01 30,513 40,137
CMB Cinema II 16,675 1.42 7,209 9,466
RWL Cinema 21,500 1.83 9,291 12,209
RWL Cinema II 67,839 5.77 29,295 38,544
HGA Cinema 133,695 11.37 57,726 75,969
Elk Invest. 76,500 6.50 33,001 43,499
Inter Alia 125,000 10.63 53,969 71,031
Hargen 8,000 0.68 3,452 4,548
HELO 180,800 15.37 78,035 102,765
Ballard 196,684 16.72 84,889 111,795
Lisle 28,284 2.40 12,185 16,099
Abernathy 67,098 5.70 28,939 38,159
CMB Cin. Vent. 250 0.02 102 148
Holding Co. 29,500 2.51 12,743 16,757
1984 Pship. 55,288 4.70 23,862 31,426
Total 1,176,213 100 507,706 668,507

IRA immediately sold the partnership interest in 1984 Development, Ltd., for $1,000 and 10 of the notes (HELO, Safari, CMB Cinema Trust, CMB Cinema Trust II, RWL Cinema Trust, RWL Cinema Trust II, HGA Cinema Trust, Elk Investment Partnership, Inter Alia, and Hargen) for $1 each to another Kanter entity, MAF, Inc. (MAF), [FN40] and IRA claimed capital losses on the sale or exchange of such notes.

As reflected by a memorandum dated July 17, 1987, Freeman (IRA's president) and Gallenberger agreed that the loans IRA was holding that had been made to Ballard and Lisle, individually, and to their respective grantor trusts would be "forgiven". IRA claimed bad debt deductions with respect to the Ballard notes, the Lisle note, and the Abernathy note.

IRA's worksheet reflects all of the 1984 sales by IRA of these various interest and accounts as set forth in the following table:

IRA Worksheet	Sale Price	Basis Loss on Average Sale
Safari	$1	$42,495 $42,494
CMB Cinema	1	30,513 30,512
CMB Cinema II	1	7,209 7,208
RWL Cinema	1	9,291 9,290
RWL Cinema II	1	29,295 29,294
HGA Cinema	1	57,726 57,725
Elk Invest.	1	33,001 33,000
Inter Alia	1	53,969 53,968
Hargen	1	3,452 3,451
HELO	1	78,035 78,034
	10	344,990 334,978
1984 Develop.	1,000	23,862 22,862
	1,010	368,850 367,840
Ballard		84,888 84,888
Lisle		12,185 12,185
Abernathy		28,939 28,939
		126,012 126,012
CMB Cinema Vent.		102
Holding Co.		12,743
		12,845

Total 507,708 493,852

On December 31, 1987, IRA sold its Int'l Films stock to Gallenberger for $1. In addition to receiving the Int'l Films stock, Gallenberger was also given $3,000. As a result of the transactions, IRA claimed the following losses on its 1987 return: (1) A $65,000 long-term capital loss on 1,500 shares of Int'l Film stock acquired October 2, 1976, with a basis of $65,000 and sold for a price of $zero; (2) a $22,862 long-term capital loss on its investment in 1984 Development, Ltd., partnership interest acquired in 1982 having an adjusted basis of $23,962 and a selling price of $1,000; (3) a $132,013 bad debt; (4) a $1,176,670 loss on business notes.
The IRA general ledger for January 1 to December 31, 1987, shows the following transactions with respect to the receivables:

Holding Co.
Unavailable history $64,000
Assets from Int'l Films ADJ 12 12,743

New balance 76,743

Int'l Films
Unavailable history 507,648
Int'l Films/loan 10/20/87 60
Payment from Int'l Films AJE 08 (507,708)

New balance 0

HELO
Unavailable history 485,825
Sell N/R to MAF ADJ 32 (485,825)
Payment from Int'l Films ADJ 08 114,870
Sold to MAF ADJ 09 (114,870)
Int'l Films on amts owed ADJ 10 (7,433)
MAF purchase HELO N/R (1)

Assets from Int'l Films ADJ 12 7,433
ADJ CR ADJ 24 1

New balance 0

Safari Trust
Payment from Int'l Films ADJ 08 62,550
Sold to MAF ADJ 09 (62,550)
Int'l Films on amts owed ADJ 10 (4,048)
Assets from Int'l Films ADJ 12 4,048

New balance 0

CMB Cinema Trust
Payment from Int'l Films ADJ 08 44,887
Sold to MAF ADJ 09 (44,887)
Int'l Films on amts owed ADJ 10 (2,905)
Assets from Int'l Films ADJ 12 2,905

New balance 0

CMB Cinema Trust II
Payment from Int'l Films ADJ 08 10,594
Sold to MAF ADJ 09 (10,594)
Int'l Films on amts owed ADJ 10 (686)
Assets from Int'l Films ADJ 12 686

New balance 0

RWL Cinema Trust
Payment from Int'l Films ADJ 08 13,660
Sold to MAF ADJ 09 (13,660)
Int'l Films on amts owed ADJ 10 (884)
Assets from Int'l Films ADJ 12 884

New balance 0

RWL Cinema Trust II
Payment from Int'l Films ADJ 08 43,101
Sold to MAF ADJ 09 (43,101)
Int'l Films on amts owed ADJ 12 (2,789)
Assets from Int'l Films ADJ 10 2,789

New balance 0

HGA Cinema Trust
Payment from Int'l Films ADJ 08 84,942
Sold to MAF ADJ 09 (84,942)
Int'l Films on amts owed ADJ 12 (5,497)
Assets from Int'l Films ADJ 10 5,497

New balance 0

Elk Investment
Payment from Int'l Films ADJ 08 48,604
Sold to MAF ADJ 09 (48,604)
Int'l Films on amts owed ADJ 10 (3,145)
Assets from Int'l Films ADJ 12 3,145

New balance 0

Inter Alia
Payment from Int'l Films ADJ 08 79,418
Sold to MAF ADJ 09 (79,418)
Int'l Films on amts owed ADJ 10 (5,139)
Assets from Int'l Films ADJ 12 5,139

New balance 0

Steve Hargen
Payment from Int'l Films ADJ 08 5,083
Sold to MAF ADJ 09 (5,083)
Int'l Films on amts owed ADJ 10 (329)
Assets from Int'l Films ADJ 12 329

New balance 0

Claude Ballard
Assets from Int'l Films ADJ 12 84,889
W/O worthless notes ADJ 28 (84,889)

New balance 0

Robert Lisle
Assets from Int'l Films ADJ 12 12,185
W/O worthless notes ADJ 28 (12,185)

New balance 0

Harold Abernathy
Assets from Int'l Films ADJ 12 28,939
W/O worthless notes ADJ 28 (28,939)

New balance 0

CMB Cinema Venture
Assets from Int'l Films ADJ 12 102

New balance 102

Invest in 1984 Development partnership
Int'l on amounts owed ADJ 10 32,854
Sold to MAF ADJ 11 (32,854)

New balance 0

Invest in Int'l Films
Unavailable history 65,000
Int'l Films stock worthless ADJ 34 (65,000)

New balance 0

Loss on sale of note receivable
Sold to MAF ADJ 09 507,608
Assets from Int'l Films ADJ 12 (162,721)
Sell N/R $1 not $10 ADJ 23 90
Sell N/R to MAF ADJ 32 831,692

New balance 1,176,670

Loss on worthless securities
Int'l Films stock worthless AJE 34 65,000

New balance 65,000

Loss on sale of 1984 Development Partnership
Sold to MAF ADJ 11 31,854
Assets from Int'l Films ADJ 12 (8,992)

New balance 22,862

Bad Debts
W/O worthless notes AJE 28 126,012
N/R-Forest worthless AJE 33 6,000

New balance 132,013

The following journal entries demonstrate the convoluted accounting Kanter engaged in to record the transactions on its books:
AJE 08: To record payment of Int'l Films $507,708 receivable by receipt of 10 receivables from Int'l Films:

Debit Credit
------- -------

N/R Safari Trust $62,550
N/R CMB Cinema Trust 44,887

N/R CMB Cinema Trust II 10,594
N/R RWL Cinema Trust 13,660
N/R RWL Cinema Trust II 43,101
N/R HGA Cinema Trust 84,942
N/R Elk Inv. 48,604
N/R Inter Alia 79,418
N/R Hargen, Karen & Steve 5,083
N/R HELO 114,870
N/R Int'l Films $507,708

AJE 09: To record the sale of the 10 receivables to MAF for $10 each:

Debit Credit
------- -------

Due from MAF $100
Loss on sale of notes rec. 507,608
N/R Safari Trust $62,550
N/R CMB Cinema Trust 44,887
N/R CMB Cinema Trust II 10,594
N/R RWL Cinema Trust 13,660
N/R RWL Cinema Trust II 43,101
N/R HGA Cinema Trust 84,942
N/R Elk Inv. 48,604
N/R Inter Alia 79,418
N/R Hargen, Karen & Steve 5,083
N/R HELO 114,870

AJE 23: To reduce the sale price of the receivables from $10 each to $1 each:

Debit Credit
------ -------

Loss on sale of N/R $90
Due from MAF $90

AJE 10: To record the receipt of Int'l Films' 1984 Development partnership interest by adjusting the 10 receivables transferred from Int'l Films and sold to MAF creating "negative" receivables:

Debit Credit
------- -------

Investment in 1984 Dev. Pship $32,854
N/R Safari $4,048
N/R CMB Cinema Trust 2,905
N/R CMB Cinema Trust II 686
N/R RWL Cinema Trust 884
N/R RWL Cinema Trust II 2,789
N/R HGA Cinema Trust 5,497
N/R Elk Inv. 3,145
N/R Inter Alia 5,139
N/R Hargen 329
N/R HELO 7,433

AJE 11: To record the sale of the 1984 Development partnership interest to MAF for $1,000:

Debit Credit
------ -------

Due from MAF $1,000
Invest. in 1984 Dev. pship $32,854
Loss on sale 1984 Dev. Ltd. 31,854

AJE 12: To again adjust assets from Int'l Films (1) to record receivables from Ballard, Lisle, Abernathy, CMB Cinema Venture, and Holding Co. and (2) to eliminate the 10 "negative" receivables, by reducing the amount of the loss on the sale of the 10 receivables to MAF by $162,721 and reducing the amount of the loss on the sale of the 1984

Development partnership interest by $8,992:

Debit Credit
------- --------

Loss on sale of N/R $162,721
Loss on sale of Pship 1984 Dev. 8,992
N/R Claude Ballard $84,889
N/R Robert Lisle 12,185
N/R Harold Abernathy (HGA) 28,939
N/R CMB Cinema Venture 102
N/R Holding Co. 12,743
N/R Safari 4,048
N/R CMB Cinema Trust 2,905
N/R CMB Cinema Trust II 686
N/R RWL Cinema Trust 884
N/R RWL Cinema Trust II 2,789
N/R HGA Cinema Trust 5,497
N/R Elk Inv. 3,145
N/R Inter Alia 5,139
N/R Hargen 329
N/R HELO 7,433

AJE 28: To write off Ballard, Lisle, and Abernathy receivables as bad debts:

Debit Credit
-------- -------

Bad debts $126,012
N/R Claude Ballard $84,889
N/R R. Lisle 12,185
N/R H. Abernathy 28,939

IRA computed the loss on sale of notes receivable from Int'l Films sold to MAF:

Sold to MAF ADJ 09 $507,608
Assets from Int'l Films ADJ 12 (162,721)
SL N/R $1 not $10 AJE 23 90

Loss on return 344,887

IRA computed the money loss on sale of 1984 Development as follows:

Sold to MAF ADJ 11 $31,854
Assets form Int'l Films ADJ 12 (8,992)

Loss on return 22,862

The adjusting journal entries and losses reported on IRA's return are summarized in the following chart:

[Note: The following TABLE/FORM is too wide to be displayed on one screen.
You must print it for a meaningful review of its contents. The table has been
divided into multiple pieces with each piece containing information to help you
assemble a printout of the table. The information for each piece includes: (1)
a three line message preceding the tabular data showing by line # and
character # the position of the upper left-hand corner of the piece and the
position of the piece within the entire table; and (2) a numeric scale
following the tabular data displaying the character positions.]
****
****
******** This is piece 1. -- It begins at character 1 of table line 1. ********

****
****
RECEIVABLES OWED TO
INT'L FILMS

AJE 8 AJE 9 AJE 23 AJE 10
--- --- --- ---
SAFARI $98,450 ($62,550) $62,550 $4,048
CMB CIN 70,650 (44,877) 44,877 2,905
CMB CIN II 16,675 (10,594) 10,594 686
RWL CIN 21,500 (13,660) 13,660 884
RWL CIN II 67,839 (43,101) 43,101 2,789
HGA CIN 133,695 (84,942) 84,942 5,497
ELK INV 76,500 (48,604) 48,604 3,145
INTER ALIA 125,000 (79,418) 79,418 5,139
HARGEN 8,000 (5,083) 4,083 329
HELO 180,800 (114,870) 114,870 7,433
--- --- ---
799,109 (507,708) 507,870

BALLARD 196,684
LISLE 28,284
ABERNATHY 67,098
CMB CIN VEN 250
HOLDING CO. 29,500

321,816

Total 1,120,925

1984 Devl 55,288 (32,855)

Total 1,176,213

Int'l Films receivable $507,708

Due from MAF ($100) $90
Loss on sale receiv (507,608) (90)
Loss on sale pship

Bad debts
1...+...10....+...20....+...30....+...40....+...50....+...60....+...70...
****
****
******* This is piece 2. -- It begins at character 74 of table line 1. *********
****
****

AJE 11 AJE 12 AJE 28
--------- --------- ---------
($4,048)
(2,905)
(686)
(884)
(2,789)
(5,497)
(3,145)
(5,139)
(329)
(7,433)

(84,889) $84,889
(12,185) 12,185
(28,939) 28,939
(102)

(12,743)

$32,854

(1,000)
162,720
(31,854) 8,992

(126,013)
74...80....+...90....+....0....

In addition to the HELO note acquired from Int'l Films, IRA had another $485,825 receivable owed by HELO. [FN41] This second note was also sold to MAF along with a $345,869 note receivable from Cedilla Investment Co., one of IRA's subsidiaries, for $1 each, resulting in an additional $831,692 loss. As of August 31, 1987, Holding Co. had total assets of $11,552,887. Holding Co. had the resources to pay either IRA or Int'l Films when the receivable was written off.
In addition to the receivables MAF purchased from IRA, MAF purchased from Kanter for $27,949, a $311,878 promissory note owing by Victorian Village and a $23,356 promissory note from S. Block for $1. Kanter sold these promissory notes to MAF to create a $307,284 loss for tax purposes. By selling the notes, Kanter claimed the loss as having been realized by way of a sale or exchange rather than as bad debt losses.
MAF neither inquired into nor independently ascertained the value of the purchased promissory notes. MAF did not

examine and consider a particular note's collectibility or the creditworthiness of its maker or obligors. MAF later wrote off the notes as uncollectible.

By the end of 1987, neither Ballard nor Lisle owed any portion of their original "loans" totaling $196,648 and $28,284, respectively, to either IRA or Int'l Films. CMB Cinema Ventures no longer owed $250 to either IRA or Int'l Films. Likewise, Ballard's and Lisle's grantor trusts' original "loans" totaling $357,464 were no longer owed to IRA or Int'l Films.

In 1987, Ballard reported $2,400,252 total income on his Federal income tax return. Included in the $2,400,252 was $212,309 interest and dividend income and $1,018,367 capital gain income. In 1987, Ballard had the resources to pay either IRA or Int'l Films the "loans" owing by him and his grantor trusts. In 1987, when IRA wrote off Ballard's "receivable" as worthless, Ballard did not report the discharge of this indebtedness as income on his 1987 return or on subsequent returns.

In 1987, Lisle reported $746,923 total income on his Federal income tax return. Included in the $746,923 was $255,707 interest and dividend income. In 1987, Lisle had the resources to pay either IRA or Int'l Films the "loans" that he had received individually and through his trusts. In 1987, when IRA wrote off Lisle's "receivable" as worthless, Lisle did not report the discharge of this indebtedness as income on his 1987 return or subsequent returns. In 1988, the year after IRA wrote off loans owing by Lisle and his trusts (RWL Cinema, RWL Cinema II, and Basking Ridge), IRA made another "loan" to the RWL Cinema Trust in the amount of $6,000. In addition, KWJ, Inc., or Kanter continued to "lend" money in 1989 and again in 1990 to Lisle's RWL Cinema Trust.

Neither Ballard, Lisle nor their trusts paid any interest to Int'l Films on the "loans" to them which were subsequently written off as worthless or sold for $1 by IRA. There were no notes or any other loan documentation evidencing the

purported loans to Ballard, Lisle, and their trusts.

On March 8, 1989, approximately 2 years after Int'l Films transferred $1,120,889 of "receivables" to IRA, Int'l Films filed for bankruptcy. At the time of the bankruptcy filing, Gallenberger was the vice president of Int'l Films and owned 100 percent of its stock. At the time of Int'l Films' bankruptcy, Int'l Films owed debts to the following creditors:

Creditors	Reason	Amount
IRS	1984 taxes	$5,500
Kanter	Legal services	750
Neal Gerber & Eisenberg	Legal services	550
Personal Service Corp.	Services	700
I & F Corp.	Services	775
Total		$8,275

Question 15 of the Statement of Financial Affairs for Debtor Engaged in Business attached to Int'l Films' Voluntary Petition for Bankruptcy asked:

Accounts and other receivables:

Have you assigned, either absolutely or as security, any of your accounts of other receivables during the year immediately preceding the filing of the original petition herein? (If so, give names and addresses of assignees)?

In response to this question, Gallenberger answered "No."

The transfer and write-off of the receivables shown in the following series of diagrams:

1983 Step 1:

TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE

1983 Step 2:

TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE

1987 Step 1:

TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE

1987 Step 2:

TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE

C. Payments to Holding Co. and Its Subsidiaries

After Ballard and Lisle left Prudential, Lisle began working for Travelers. Schaffel paid IRA $213,750, 50 percent of the fees he earned from the first Travelers' financing approved by Lisle. After the first payment, Schaffel failed to pay Kanter on succeeding projects financed by Travelers. After discussions with Lisle, Schaffel agreed to make payments to Kanter, but under a different arrangement. Kanter directed Schaffel to make the payments to Holding Co. Schaffel paid Holding Co. $600,000 in 1984, $1,160,000 in 1985, and $1,003,500 in 1986 for transactions with Travelers.

Frey and Essex made the following payments to Holding Co., during the years 1981 through 1989:

Year	Frey	Essex	Total
1981	$80,616	--	$80,616
1982	--	$70,538	70,538
1983	16,200	64,125	80,325
1984	113,827	109,013	222,840
1985	256,557	98,325	354,882
1986	--	65,835	65,835
1987	33,570	98,753	132,323
1988	--	96,188	96,188
1989	--	42,332	42,332
Total	500,770	645,099	1,145,879

The following diagram shows the money paid to IRA and Holding Co. by Schaffel for the Travelers financing transactions, and by Essex and Frey to Holding Co. and Zion:

TABULAR OR GRAPHIC MATERIAL SET AT THIS POINT IS NOT DISPLAYABLE

D. Distributions to Kanter

Kanter had funds in both the Administration Co. Special E Account and the Special Account. Administration Co. paid some of Kanter's business and personal expenses out of Kanter's funds in these accounts. During 1982 Kanter received the following amounts from the payers or sources indicated:

Payer/Source	Funds Received
Holding Co.	$787,129
Computer Placement Service	40,000
Special E Account	190,078
Special Account	286,000
Total	$1,303,207

In 1983, Administration Co. paid $143,489 in employee compensation and distributed over $500,000 as nonemployee compensation, including $400,000 to the Rainbow Trusts (Rainbow Trust Nos. 1-25). Prior to 1987, Administration Co.'s assets consisted primarily of cash and receivables. For example, for the years 1983, 1984, and 1986, Administration Co. listed the following assets on its tax returns:

Fiscal Year	Cash on Hand	Current (Notes Receivable)	Assets	Total Assets
6-30-83	$77,735	$ 998,118		$1,117,457
6-30-84	23,941	4,501,125		4,577,701
6-30-86	55,821	4,365,144		4,512,704

Some of Administration Co.'s receivables represented money distributed to Kanter or trusts for the benefit of his family. For example, in 1984, Administration Co. distributed

$660,000 to Kanter that was recorded as a receivable. Administration Co.'s trial balance for the twelve months ended 6/30/84 reflects the following notes receivable from Kanter and his grantor trusts:

Entity	Amount
Everglades Trust 1-5	$23,595
Everglades Trust 2	1,000
Everglades Trust 3	1,000
Everglades Trust 4	1,000
Kanter, Burton W.	660,845
Total	$687,440

As of January 1, 1987, Kanter's general ledger indicated that Administration Co. had distributed a total of $1,056,751 to him. By the end of Administration Co.'s fiscal year ended June 30, 1987, its total assets were as follows:

Fiscal Year	Cash on hand	Current Assets (Notes Receivable)	Total Assets
6-30-87	$ 100	$6,929	$63,880

Administration Co.'s return for the year ended June 30, 1987, was the last return filed for Administration Co. Although the receivables on Administration Co.'s books decreased, as of October 31, 1987, Kanter still had an outstanding loan from Administration Co. in the amount of $1,346,641.
Administration Co. filed for bankruptcy. Sometime in either 1987 or 1988, during the bankruptcy proceedings, Gallenberger gave to Kanter Administration Co.'s records, including Administration Co.'s bank statements and canceled checks and the records related to Kanter, IRA, and Holding Co. The documents were never returned by Kanter to Gallenberger. The records would show the amount of

moneys in Administration Co.'s accounts held for Kanter and the related Kanter entities. Administration Co.'s bankruptcy was terminated on April 19, 1988.
During Administration Co.'s bankruptcy, a new company called Administrative Enterprises began its operations. By the end of the year December 31, 1987, Administrative Enterprises filed its initial return, which reported cash on hand of $11,548 and current assets (receivables) of $100.
For each of the years 1979 through 1989, Kanter filed his individual Federal income tax returns which reported adjusted gross income and income taxes paid as follows:

Year	Adjusted Gross Income (Loss)	Tax Paid
1978	($44,386)	$ 1,671
1979	(105,084)	--
1980	(155,026)	--
1981	(53,614)	--
1982	(287,536)	--
1983	(819,449)	--
1984	(804,482)	--
1985	(954,695)	--
1986	(1,529,213)	--
1987	(2,004,257)	--
1988	(1,340,459)	--
1989	(1,331,576)	--

Kanter paid no Federal income taxes for an 11-year period, and only minimum tax in 1978 of $1,671. However, he did pay self-employment tax for the years 1978 ($1,434), 1979 ($1,855), 1980 ($2,098) and 1983 ($3,338).
E. Examination of Petitioners' Returns
In November 1989, the Internal Revenue Service began an examination of Kanter's income tax returns. Several years were under examination.
In connection with the investigation of IRA for 1987, an IRS

agent received documents from Gallenberger and Kanter. The types of documents which the agent received included financial records, billings, invoices, expense items and various accounting records and corporate records. The agent reviewed the records to determine who the shareholders of IRA were in 1983. The records indicated that the shareholders of IRA for the year 1983 were: The Ballard Family Trust; The Lisle Family Trust; Weisgal as trustee of the Bea Ritch Trust; and Schott. IRA's minute books reflected that, as of 1984, the only shareholder of IRA was the Bea Ritch Trusts.

Pursuant to a summons to testify, Ballard was interviewed by IRS agents in February of 1990 at his residence in Florida. At the time of the interview, Ballard was not under audit. Ballard understood that he was not under audit and testified under oath. The purpose for the interview was to ask Ballard questions about Kanter's transactions involving Ballard. Sometime after the interview, Ballard's and Lisle's returns also were audited. The group of examining agents auditing the returns of Kanter, Ballard, and Lisle encountered difficulties because of the numerous entities related to Kanter involving transactions with him.

The investigation expanded. The IRS began interviewing more and more witnesses. By November of 1989, the Criminal Investigation Division (CID) was conducting an investigation.

In February 1990, Kanter sent letters to Ballard's and Lisle's children terminating the payments they had been receiving. In Kanter's letter, he stated that the Ballard and the Lisle children had not done anything for a number of years and blamed Freeman for continuing to have paid them. On November 20, 1990, Lisle wrote a letter to Kanter explaining to Kanter the reasons why he managed Carlco for no compensation. Lisle stated that there could have been a conflict of interest with Travelers, and it was "a learning experience managing a municipal bond fund." He told Kanter that he was going to begin charging a fee because

what he was doing took more of his time. Likewise, after Ballard was interviewed by the IRS in 1990, Ballard began taking a salary from TMT.

By letter dated December 17, 1992, Kanter wrote Ballard regarding an obligation purportedly due by Ballard to Int'l Films in the amount of $196,684. In the letter, Kanter requested that Ballard pay $120,000 in satisfaction of this prior obligation, to "simply avoid any controversy with me or anyone else." The $196,684 was the amount that had been written off by IRA as a bad debt in 1987.

During the audit of Kanter's 1987 and 1988 returns, the IRS requested information including data pertaining to transactions with the Five. The documents produced by Kanter during the audit were in many instances incomplete with many missing pages. Moreover, no documents pertaining to the $1,345,641 that Kanter received as a loan from Administration Co. were provided. Kanter, Ballard, and Lisle did not produce the records sought by the IRS in connection with the business entities relating to them. Nor did the IRS receive records voluntarily from any of the entities that had transactions with them. The records that were produced generally were relevant only to Schedule A substantiation items, such as records related to charitable contributions.

As a result of petitioners' failure to produce documents voluntarily, the complexity of the transactions involved, and the number of entities involved, the IRS issued summonses in order to obtain the necessary documents and information to conduct the examination. Numerous summonses were issued to Kanter, Ballard, and Lisle, as well as to many of the entities involved.

The IRS issued the following summonses to the following on the dates indicated:

Summons issued to	Tax Year	Date of Summons
Claude Ballard	1984	July 25, 1991

Linda Gallenberger 1984 January 10, 1991
In the matter of Claude & Mary Ballard
Linda Gallenberger 1984 January 10, 1991
In the matter of Robert Lisle & Donna Lisle
Linda Gallenberger 1984 January 10, 1991
In the matter of Claude & Mary Ballard
Donna Lisle 1984 July 30, 1991
Linda Gallenberger 1984 January 10, 1991
Robert Lisle 1988 July 30, 1991
Linda Gallenberger, Officer 1984 January 10, 1991
Principal Service Corp.
In the matter of Robert Lisle & Donna Lisle
Principal Service Corp. 1983, October 1, 1990
1985-1988
In the matter of Burton & Naomi Kanter
Mildred Schott 1983, April 30, 1990
1985-1988
In the matter of Burton & Naomi Kanter

Summonses were also served on Administrative Enterprises, Principal Services, Zion, and BK Childrens Trust.
The summons to Ballard dated July 25, 1991, requested, in part, documents in his possession pertaining to TMT, IRA, and the Orient Trust.
One of the summonses to Gallenberger dated January 10, 1991, in the matter of Ballard, requested, in part, documents in her possession pertaining to TMT, KWJ Co., Sherwood Associates, Orient Trust, Essex Hotel Management, and all documents evidencing loans to and from the Ballards with TMT. The other summons to Gallenberger dated January 10, 1991, in the matter of Ballard, requested, in part, documents in her possession pertaining to IRA, KWJ Co., Sherwood Associates, Essex Hotel Management, Int'l Films, and all documents evidencing loans to and from the Ballards with IRA.
The summons to Gallenberger dated January 10, 1991, in the matter of Lisle, requested, in part, documents in her

possession pertaining to IRA, Int'l Films, KWJ Co., Sherwood Associates, Essex Hotel Management, and all documents evidencing loans to and from the Lisles with IRA.
The other summons to Gallenberger dated January 10, 1991, in the matter of Lisle, requested, in part, documents in her possession pertaining to Carlco, Christie Trust, KWJ Co., Sherwood Associates, and Essex Hotel Management and loans between Carlco and the Lisles.
The summons to Donna Lisle dated July 30, 1991, requested, in part, documents in her possession as officer of Carlco pertaining to Carlco, IRA, and the Christie Trust.
The summons to Lisle dated July 30, 1991, requested, in part, documents in his possession pertaining to Carlco, IRA, Christie Trust, and loans between Lisle and IRA, Carlco, and Christie Trust.
The summons to Gallenberger as an officer of Principal Services dated January 10, 1991, requested, in part, documents in Principal Services's possession pertaining to Carlco, Christie Trust, and loans related to Lisle.
The summons to Principal Services dated October 1, 1990, requested, in part, documents pertaining to Principal Service Corporation, IRA and its subsidiaries, Holding Co. and its subsidiaries, BWK, Inc., and the Bea Ritch Trusts. The summons requested production of the cash receipts, cash disbursement journals, general ledgers and ledgers for all bank accounts including the Special E account. The summons also requested production of documents pertaining to any corporation or partnerships in which Kanter, his family or family trusts were shareholders.
The summons to Schott dated April 30, 1990, requested, in part, documents pertaining to Cedilla Company, IRA and its subsidiaries, Kanter, Ballard, Lisle, Schaffel, Frey, Weaver, KWJ Corp., Motor Hotel Management Inc., Essex Hotel Management Co., and Schnitzer-PMS.
The documentation sought in the summonses served on petitioners, Principal Services, Linda Gallenberger on behalf of Principal Services, and Mildred Schott was relevant to the

issues in these cases. Petitioners, Gallenberger, Principal Services, and Schott did not voluntarily turn over documents and information listed on the summonses to the agents during the audit.

None of the above information requested was produced pursuant to the summonses. In fact, petitioners did not produce anything in response to the summonses, including documents evidencing loans between themselves and the various entities.

Principal Services maintained Kanter's personal records, the records of his family entities and trusts, the records of IRA and Holding Co. Kanter controlled Principal Services and Gallenberger. During discovery in these cases, respondent requested receipts and disbursement journals for Holding Co. for all of the years at issue. Kanter first promised to produce Holding Co.'s books and records in the possession of Principal Services and then, in early February 1994, notified respondent that the Holding Co. was a third-party over which he had no control. Initially, Gallenberger had in her possession the records of Holding Co. for the years 1986, 1987, and 1988. After respondent requested production of the Holding Co. records, Kanter never asked Gallenberger for them. At some point, however, she turned those records over to Kanter.

On April 1, 1994, the Government sought enforcement of four summonses that had been served in 1990 and 1991 on Administrative Enterprises, Principal Services, Zion, and BK Childrens Trust (which is one of the twenty-five trusts which comprise the Bea Ritch Trust group). See United States v. Administration Co., 74 AFTR 2d 94-5252, 94-2 USTC par.50,479 (N.D.Ill.1994). On April 4, 1994, the District Court issued an order to show cause why the Kanter-related entities should not be compelled to obey the four summonses.

In connection with the instant cases, Gallenberger was served by respondent with a discovery subpoena to produce documents. On May 18, 1994, Gallenberger appeared at the

deposition without the requested documents. At the deposition, Gallenberger stated that she did not have the records because of a 3-year retention policy. Even under Gallenberger's alleged records retention policy, however, documents of an individual or entity under audit were not destroyed until the audit was completed.

On the following day, May 19, 1994, a hearing was held in the District Court on the Government's motion to enforce the administrative summonses. At the hearing, Weisgal, who was served as the named trustee of the BK Childrens Trust, admitted that, after he received the summons, some of the documents, including documents relating to the Kanters, had been turned over to Administration Co. and that some had been discarded as part of a 3-year record retention and discard policy.

Gallenberger, who had been served with summonses as president of Administration Co., Principal Services, and Administrative Enterprises, also admitted at the hearing that she disposed of some documents after she received the IRS summons and claimed that documents relating to Administration Co. were never returned to her from bankruptcy counsel. [FN42] On May 20, 1994, the District Court ordered the records sought by the summonses be produced to the IRS by May 24, 1994. United States v. Administration Co., 74 AFTR 2d 94- 5252, 94-2 USTC par. 50,480 (N.D.Ill.1994).

Although Gallenberger appeared, testified, and produced some documents on May 24, 1994, in accordance with the District Court's order, she did not search all of the approximately 52 filing cabinets of records in her possession, but instead looked in every fifth or seventh file. The Government filed another motion on June 10, 1994, and, on June 22, 1994 a hearing was held. See United States v. Administration Co., 74 AFTR 2d 94-5256, 94-2 USTC par. 50,480 (N.D.Ill.1994). At this second hearing, Gallenberger admitted that Principal Services operated much like a registered agent and a document repository, but existing

primarily for the Kanters' benefit. Gallenberger knew that most of the documents held by Principal Services were related to Kanter entities. The District Court concluded that Gallenberger's sampling of documents did not discharge her duty to make all reasonable efforts to comply with the court's order. Finding a "glaring deficiency in her compliance," the District Court held Gallenberger in contempt of court and granted her until July 1, 1994 to comply fully with the court's order. Id. at 5258, 94-2 USTC ¶ 50,480 at 85,770. Gallenberger complied with the District Court's order of June 22, 1994, but appealed the order to the Court of Appeals for the Seventh Circuit. The Court of Appeals affirmed the District Court's order in United States v. Administrative Enters., Inc., 46 F.3d 670 (7th Cir.1995). [FN43]

The trial of these cases commenced on June 13, 1994. At the start of the trial, respondent's counsel indicated that subpoenas duces tecum had been served on various entities for documents that were to be produced at that time. Counsel for IRA and Kanter informed the Court that the subpoenas requesting documents from IRA, BWK, Inc., Carlco, and TMT had been served on Gallenberger, but that Gallenberger was not the custodian of the records. Rather, Kanter was the custodian of the records. Respondent immediately served Kanter with a subpoena requesting records relating to Holding Co. and its subsidiaries, IRA and its subsidiaries, Carlco, TMT, and BWK, Inc. The subpoena requested corporate minute books, corporate minutes, articles of incorporation and all amendments thereto, stock registers, stock certificates, certificates of authority, bylaws and all amendments thereto, and all subscription agreements and agreements thereto. In addition to the books and records, respondent also requested production of documents reflecting the ownership of IRA, Holding Co., Carlco, TMT, and BWK. Specifically, respondent requested production of the following original documents:

All books, records or other documents evidencing the ownership of the following entities: IRA, Holding Co.,

Carlco, TMT, BWK, ... including but not limited to stock ledgers and records of stockholders.

Although Kanter produced some documents, many records were not produced. Absent from the record are resolutions by the board of directors of Carlco and TMT setting forth the preferences of the preferred stock.

With respect to Holding Co., Kanter produced Holding Co. trial balances only for the years 1980 and 1981. Respondent had from prior audits partial general ledgers of Holding Co. for 1983, 1984, and 1985, and partial trial balances of Holding Co. for 1983, and 1984. There are no receipts and disbursement journals, general ledgers, or trial balances for Holding Co. for the years 1980, 1981, 1982, 1985 (partial), 1986, 1987, 1988, and 1989. Respondent sought the records because the Five made payments to Holding Co. during those years.

When the trustees of Kanter's family trusts, Baskes and Weisgal, were asked to produce documents, they, likewise, failed to do so on the ground that they did not have the requested information in their possession.

Gallenberger took the position that a request for documents in the possession of Principal Services was a request for the documents of Principal Services, and not the records maintained by Principal Services for Kanter or Kanter-related entities. She claimed that Principal Services had a policy of refusing to turn documents over to anyone other than the owner.

OPINION

By this point, the complexity of these cases is apparent. That complexity is reflected in the sheer magnitude of the record and is exacerbated by the contentiousness of the parties. The trial in these consolidated cases lasted almost 5 weeks, and produced a transcript of 5,411 pages. The parties' combined briefs contain 4,668 pages and address over 40 issues. We have plodded through thousands of exhibits containing hundreds of thousands of pages. Not surprisingly, our task of finding the facts has been laborious and frequently

frustrating.

Unless otherwise indicated, references hereinafter to petitioners are to Ballard, Lisle, and Kanter, collectively.

I. Position of the Parties

Respondent contends that the payments made by the Five to the various Kanter entities were kickbacks paid to petitioners for their influence and assistance in acquiring business with Prudential, Travelers, and others. Specifically, respondent alleges that (1) when Ballard and Lisle were employed by Prudential, petitioners received kickbacks from the Five that petitioners agreed to split 45 percent each to Ballard and Lisle and 10 percent to Kanter (the Prudential transactions), (2) when Lisle worked for Travelers, Lisle and Kanter received kickbacks that were split 90 percent to Lisle and 10 percent to Kanter (the Travelers transactions), and (3) Kanter alone received kickbacks for transactions that were not necessarily related to Prudential and Travelers (the Kanter transactions).

Respondent contends that the payments constituted income to petitioners that they failed to report on their Federal income tax returns. It is asserted that the payments related to the Prudential transactions are taxable 45 percent each to Ballard and Lisle and 10 percent to Kanter, the payments related to the Travelers transactions are taxable 90 percent to Lisle and 10 percent to Kanter, and the payments related to the Kanter transactions are taxable 100 percent to Kanter. In the alternative, respondent asserts that, if any of the payments related to the Prudential and Travelers transactions are not taxable to Ballard and Lisle, the payments are taxable 100 percent to Kanter.

Respondent maintains that Kanter, in carrying out the Prudential and Travelers schemes, routed the kickback payments through IRA and Holding Co., two entities that he controlled, to conceal from Prudential and Travelers (Ballard's and Lisle's employers) the fact that Ballard and Lisle were receiving kickbacks. As a further part of the Prudential kickback scheme, respondent argues, Kanter later

directed and allocated much of the kickbacks IRA received from the Five to IRA's subsidiaries, Carlco, TMT, and BWK, Inc., roughly in accordance with the respective 45-45-10-percent split agreed to by Ballard, Lisle, and Kanter. In doing this, respondent claims that Ballard, Lisle, and Kanter each then controlled and managed his respective share of the kickbacks from the Prudential scheme. Although Ballard's and Lisle's purported shares of the kickbacks were not immediately paid to them, respondent asserts that substantial funds eventually were either paid out or provided to them and their families through "loans" and "consulting payments" to their children.

Respondent argues that IRA, its subsidiaries Carlco, TMT, and BWK, Inc., and Holding Co. were sham or dummy corporations that should not be recognized as separate taxable entities. In the event the Court decides that the corporations were not sham or dummy corporations, respondent argues in the alternative that petitioners are taxable on the income under the assignment of income doctrine or pursuant to section 482.

Petitioners, on the other hand, dispute respondent's characterization of such payments as kickbacks and their attribution to Kanter, Ballard, and Lisle. Petitioners deny that any kickback schemes existed and contend that the payments from the Five were properly taxable to IRA, Holding Co., or one of their subsidiaries. Petitioners contend that all of the payments were reported on the respective tax returns of IRA and Holding Co. during the years at issue and that such income was properly taxable to IRA, Holding Co., and/or their subsidiaries, and not to Ballard, Lisle, and/or Kanter, as respondent asserts.

Petitioners contend that the corporations were not shams and that the assignment of income doctrine and section 482 are inapplicable.

II. Omitted Income

Since all of the payments by the Five were made to entities associated with and controlled by Kanter, and, from there,

the payments flowed through to Kanter, Ballard, and Lisle, it is appropriate to consider first whether the payments made to Kanter's entities are attributable to petitioners, because if we conclude that such payments were not attributable to them, it follows that such payments or portions thereof are attributable to the entities that received the payments.

A. The Transactions

We begin by examining the transactions at issue.

1. The Hyatt Payments

In a joint venture with others, Prudential built the Embarcadero Hotel and sought a management company to operate it. Originally, only Webb and Intercontinental were considered for the management contract on the hotel. Although Hyatt had successfully negotiated the management contract for the Houston Hyatt Hotel, in which Prudential was involved, Lisle was not interested in having Hyatt bid on the management contract for the Embarcadero Hotel. Pritzker offered to pay 10 percent of the management fees to Weaver if he could get Prudential to award the contract to Hyatt. Weaver then convinced Lisle to allow Hyatt to bid on the contract.

Representatives of the hotel's owners, including Lisle and Ballard representing Prudential, then met with Webb and Pritzker to obtain bids on the management contract. Apparently, since Intercontinental was not represented at the meeting, Intercontinental either withdrew or was eliminated from consideration prior to the meeting. Webb refused to submit a bid at the meeting because he thought he had previously been promised the contract. Hyatt submitted the only bid and was subsequently awarded the contract.

Hyatt then executed a written agreement with Weaver's KWJ Corp. dated February 25, 1971, pursuant to which Hyatt agreed to pay KWJ Corp. 10 percent of the management fees Hyatt earned from management of the hotel. The agreement acknowledged that "KWJ" was the principal factor in bringing Hyatt Corp. and the owners of the Embarcadero Hotel together and aiding in the negotiations.

The hotel opened in May 1973. Apparently, Hyatt did not make a profit the first year, and no payments were made to KWJ Corp.

In 1975, a dispute arose between Weaver and Hyatt as to whether KWJ Corp. was entitled to management fees for 1974. The dispute was settled in November 1975.

Before the dispute was settled, Weaver and Kanter agreed that Weaver would sell all the stock of KWJ Corp. to IRA. They executed an agreement dated March 10, 1976, acknowledging the agreement. The agreement gave IRA the option to purchase the stock within 4 years for $150,000 plus an amount equal to 30 percent of all payments received by KWJ Corp. from Hyatt after the purchase. In September 1979, Kanter informed Weaver that he wanted to proceed with the purchase of the KWJ Corp. stock. The sale was made effective retroactively to November 1, 1978.

Petitioners would have us end our examination of the transaction at this point and hold that the sale was a valid arm's-length sale of the stock to IRA. The Court declines to do so because it would ignore the true substance of the transaction and give new meaning to the expression "blind justice". We think the true substance of the transaction is clearly disclosed when one follows the flow of the money.

The only activity conducted by KWJ Corp. and later the KWJ Co. partnership, was receiving the Hyatt payments. IRA was to pay $10,000 of the purchase price in November 1979 and the balance by August 1980. Hyatt paid over $170,000 to KWJ Corp. in 1979. Thus, IRA simply paid the purchase price from the Hyatt payments.

After paying 30 percent of each of the Hyatt payments to Weaver, the remaining funds were (1) distributed as "consulting fees" to Ballard's and Lisle's children, (2) filtered along with other payments from the Five through IRA, Int'l Films, and HELO as loans to Ballard, Lisle, and Kanter, and (3) distributed to Carlco, TMT, and BWK, Inc. Lisle's control over the Carlco assets, Ballard's control over the TMT assets, and Kanter's control over the BWK, Inc. assets went

unfettered. Petitioners had unrestricted power to use the funds for their personal benefit and in fact did so.

The record clearly and convincingly shows that Weaver agreed to split his Hyatt commissions with Ballard and Lisle in exchange for their influence in having the management contract awarded by Prudential and its co-owners to Hyatt. The record also shows by clear and convincing evidence that Lisle and Ballard agreed to pay Kanter 10 percent of their share of the payments in exchange for Kanter's facilitating the concealment and distribution of the funds. Additionally, the transfer of the stock to IRA allowed petitioners to offset the income from the Hyatt payments with tax-shelter losses claimed on IRA's consolidated returns. The entire arrangement was implemented in order to conceal Ballard's and Lisle's participation from Prudential and Kanter's participation from Hyatt and to avoid Federal taxes.

When Weaver sent to IRA the 1983 payment from Hyatt for the management fees earned in 1982, he wrote in the letter dated March 29, 1983: "Will you please deposit and issue appropriate checks to the participants." If there was no agreement to split the fees with petitioners, we think it more likely that Weaver would simply have directed IRA to remit to him his 30 percent. KWJ Corp. had not been liquidated; Carlco, TMT, and BWK were not "active" (no stock had been issued); and the KWJ Co. partnership had not yet been formed. We are convinced that the reference to the "participants" was to Ballard, Lisle, and Kanter, as well as Weaver.

Petitioners assert that Ballard and Lisle did not have the power to award the contract to Hyatt in part because their positions with Prudential did not give them such authority and in part because there were others besides Prudential participating in the project. Although Ballard and Lisle may not have been in a position to guarantee that the contract would be given to Hyatt, their opinions as Prudential executives would have influenced the other owners. Certainly a negative opinion with respect to a bidder would

have foreclosed the possibility of the bidder getting the contract. Strum, CEO of the Prudential Realty Group for Development and Retail Property Investments, testified that Ballard had the "hierarchy power" either to influence the selection of contractors or to prevent a project from going forward. Initially, Lisle used his "prevention power" to keep Hyatt even from being considered for the management contract. Ballard and Lisle may not have had the power to guarantee that Hyatt would get the contract, but they did have the power to guarantee that it would not get the contract.

Kanter claims that he did not know about Hyatt's arrangement with Weaver until Pritzker later asked him about some language in the agreement. The copies of the correspondence between Weaver and Hyatt concerning the dispute over the computation of the fees were copies that Kanter had in his records. He claimed that Pritzker gave him the copies in the course of Pritzker's consulting with him regarding the dispute with Weaver.

The letter acknowledging Weaver's prior understanding that he would sell all the stock in KWJ Corp. to Kanter's "client" (IRA) for $150,000 is dated March 10, 1976. Kanter admitted that he and Weaver had been discussing the sale for some time before March 10, 1976. At trial he testified that he did not know whether it was a few months before or a much longer period of time. Kanter testified that "J.D. [Weaver] needed money and was clearly unhappy with what might be the interpretation of the contract in light of his dispute with Abe [Pritzker], and it led to this letter."

We find Kanter's testimony to be implausible. We find it incredible that an attorney consulting with a very important client about a contract dispute would surreptitiously negotiate with the other party to the contract to purchase essentially the same contract that was the subject of the dispute and on which the attorney was giving advice.

We are not convinced that Kanter obtained the copies of Hyatt's correspondence with Weaver from Pritzker rather

than from Weaver. Kanter was not Hyatt's attorney. He represented the Pritzker family, but Hyatt had its own attorneys, including members of the Pritzker family who themselves were attorneys. Kanter testified that he had very limited involvement with respect to the Embarcadero Hotel project and that, although Hyatt Corp. had full-time tax counsel representing it, there were some isolated tax questions with which he was involved. He testified that, at that time, his office did not do anything but tax work and he had no involvement with any other part of the project or contract.

Kanter also claims that Weaver gave IRA 4 years to buy the stock for two reasons: First, because Weaver needed the money, and, second, because Hyatt was attempting to become privately owned and Hyatt would not want to disclose the agreement. Kanter claimed that the reason Hyatt would not want to disclose the agreement was because others might expect similar fee-splitting arrangements in negotiating for other projects.

Again, Kanter's explanation is implausible. If Weaver needed the money, we do not think he would agree to put the sale off for up to 4 years. Furthermore, Hyatt's contract with KWJ Corp. already existed. Hyatt either had to disclose its contract with KWJ Corp. in accordance with the securities laws or it did not. We fail to see how the sale of the stock to IRA would affect the disclosure requirement unless IRA was somehow considered an interested party or an insider with respect to Hyatt Corp. We think it more likely that Kanter did not want to disclose the purchase to Hyatt Corp. or the Pritzkers. In fact, Kanter did not disclose the purchase of the stock, the liquidation of KWJ Corp., or the assignment of the contract rights to the KWJ Co. partnership until sometime around 1992.

Furthermore, there was no reasonable explanation for Weaver's selling the stock in KWJ Corp. to IRA for $150,000 plus an amount equal to 30 percent of all payments received by KWJ Corp. from Hyatt. Weaver was experienced enough

to know that the contract was worth millions of dollars. By selling the stock, he effectively gave up 70 percent of the contract rights. It would have been less costly to hire another attorney to represent him in enforcing the agreement. Moreover, if Weaver had expected Hyatt to make the payments more readily because of Kanter's relationship to IRA and the Pritzkers, then Weaver would have notified Hyatt of the sale of the stock. That he did not do. Instead, he continued to receive the payments from Hyatt which he then forwarded to IRA. It is clear that Weaver and Kanter intentionally concealed the sale of the KWJ Corp. stock from Hyatt until Kanter's relationship with Weaver deteriorated around 1992.

Similarly, the Court also finds that the "consulting payments" Kanter arranged to have KWJ Corp., and later the KWJ Co. partnership, pay to Ballard's and Lisle's children from about 1983 through 1989 were part of the kickback scheme. Although referred to as "children", they were adults and were all engaged in other employment, and no services were performed or expected of them for these payments. We hold that the Hyatt payments, less Weaver's 30 percent, were attributable to services provided by Kanter, Ballard, and Lisle.

2. The Frey Arrangement

Frey was engaged in the business of converting apartment complexes into condominiums. Frey agreed to share fees with Kanter in any project for which Kanter provided investors.

Frey's agreement that he would share development and management fees with Kanter was formalized in two separate written agreements each dated October 12, 1981. One agreement was between Frey and IRA's subsidiary Zeus, and the other agreement was between Frey and Holding Co.

The written agreement with Zeus covered development fees and profits shares from all condominium conversions of property of or for Prudential, including all prior and future

conversions. The agreement did not provide for termination by either party and did not require Zeus to provide any funds or services.

All of Zeus' income was attributable to the payments from the Frey corporation, interest income, and income from partnerships. The commission payments from Frey were unrelated to Zeus' investment in the partnerships. Zeus did not provide any capital or services for the commission payments. Frey agreed to pay Zeus and made the payments because Kanter used his influence with Ballard and Lisle, who in turn used their positions of authority at Prudential to influence Prudential in using Frey as the developer in the conversion of Prudential properties into condominiums. The payments were accumulated in Zeus (or distributed as loans) until 1983. In 1983, Zeus distributed the funds to IRA. In 1984 IRA distributed the funds to Carlco, TMT, and BWK, Inc., effectively distributing the funds 45 percent each to Ballard and Lisle and 10 percent to Kanter. Frey paid Zeus $103,500 in 1984 and $128,763 in 1985 (totaling $232,263). Although the money was accumulated in Zeus until it purchased the preferred stock in Windy City in 1986, IRA distributed $249,870 to the KWJ Co. partnership as "loans" from 1984 to 1989.

It is clear that the payments made by Frey to Zeus were for services provided by Ballard, Lisle, and Kanter.

The second agreement (between Frey and Holding Co.) applied to "capital contribution, profits and losses and Developers' Fees" for all condominium conversions excluding the developers' fees from Prudential projects that were covered by the agreement with Zeus. The agreement could be terminated by either party with 45 days' prior notice with the termination effective only with respect to new condominium conversions. Although the second agreement required Holding Co. to make capital contributions with respect to Holding Co's. investment as a partner, it did not require Holding Co. to make any contributions or provide any services in exchange for its

share of the developer fees at issue in this case. Furthermore, Holding Co. did not pay for its partnership interest. Rather, Frey paid the capital contributions, and Holding Co.'s share of profits was reduced by a portion of the contributions as the profits were distributed.

Frey paid a portion of his development fees and profit interest to Holding Co. for Kanter's services of providing other investors in the projects. Holding Co. did not provide any services or capital with respect to those fees.

We hold that the payments from Frey to Zeus are attributable to services provided by Ballard, Lisle, and Kanter, and the payments to Holding Co. are attributable to services provided by Kanter.

3. The Schaffel Arrangement

The arrangement between Schaffel and Kanter originated at the dinner with Ballard and Lisle in New York. At the meeting, Kanter offered his and "his associates" ' help in obtaining deals from which Schaffel could earn fees as a broker, provided Schaffel would agree to pay Kanter half of any broker's fees Schaffel received from the deals. Schaffel agreed, and Kanter helped Schaffel negotiate agreements with Torcivia and Walters. Pursuant to those agreements, Torcivia and Walters agreed to pay Schaffel 1 percent of the gross amount of the contract price of any construction contract that Schaffel helped obtain for their companies. Schaffel then executed a letter agreement to pay 50 percent of the fees he received for construction jobs in which Kanter or his "associates" had been instrumental or helpful in obtaining for Torcivia or Walters. Although the letter agreement is addressed to IRA, it is clear that the agreement was with Kanter and the reference to associates was to Ballard and Lisle.

As a result of the introduction to Ballard and Lisle, Schaffel began doing millions of dollars of business with Prudential, including construction contracts and financing for Torcivia and Walters, as well as others. From 1979 to 1983, Schaffel paid IRA $1,184,876 from these Prudential transactions.

After Ballard and Lisle left Prudential, Schaffel stopped negotiating contracts with Prudential. Instead, he began negotiating contracts for Torcivia and Walters with Lisle at Travelers. Schaffel paid IRA $213,750 from the first Travelers transaction. After that payment, however, Schaffel stopped paying IRA a share of the fees he earned on Travelers transactions. When Kanter contacted Schaffel and inquired as to why Schaffel was not remitting half the fees from Travelers transactions to IRA, Schaffel claimed that the prior agreement related to Prudential transactions did not apply to Travelers transactions. In the August 28, 1984, letter to Schaffel, Kanter asserted that the arrangement should continue because, in his view, Travelers had replaced Prudential as the principal source of the transactions because of the "very personnel" to whom Schaffel had been introduced. It is clear that the reference to personnel was to Ballard and Lisle.

After discussing the situation with Lisle, Schaffel agreed to resume payments for fees earned on Travelers transactions. Instead of paying IRA, however, Kanter had Schaffel send the payments from Travelers transactions to Holding Co. Ballard and Lisle knew that Kanter had an arrangement with Schaffel to share in the fees Schaffel earned on certain business deals, because they were present at the dinner meeting when Kanter initially proposed and discussed the arrangement with Schaffel. When Kanter and Schaffel had their dispute over whether IRA was entitled to a share of Schaffel's fees on business deals with Travelers, Lisle was concerned that a lawsuit between the two might cause problems for Lisle with Travelers. Lisle was concerned because he was involved with the arrangement and benefited from it.

The payments from Schaffel for the Prudential transactions were accumulated in IRA until the formation of Carlco, TMT, and BWK, Inc. In 1984, IRA transferred funds to the three new corporations in a 45-45-10 ratio, effectively transferring 45 percent to Lisle, 45 percent to Ballard, and 10

percent to Kanter. It is clear that payments Schaffel made to IRA were in part for Kanter's service of introducing Schaffel to Ballard and Lisle, and that Kanter agreed to share the payments with Ballard and Lisle in a 45-45-10 split. Although it is also clear that the payments Schaffel made to Holding Co. were for Kanter's prior service in introducing Schaffel to Lisle, the record does not show that the funds flowed through from Holding Co. to Lisle. The payments at issue do not include the payments Schaffel made through FPC Subventure. Lisle included 90 percent of the FPC Subventure payments in the income reported on his returns. There is no evidence in the record that Kanter otherwise agreed to share or did share the fees from the Travelers transactions at issue here with Lisle. Thus, we find that none of the payments were paid to Lisle for his services.

4. The Schnitzer Arrangement

In 1974, Schnitzer's holding company, Century, purchased Schnitzer-PMS (Fletcher Emerson at the time) for $1.3 million. The purchase price was based roughly on five times Fletcher Emerson's pretax earnings of approximately $250,000. [FN44] At the time of the purchase, Schnitzer-PMS had been managing a relatively small number of Prudential's commercial properties. Schnitzer wanted to expand Schnitzer-PMS' business, including its business with Prudential. Schnitzer approached Ballard and offered to give Prudential a 50- percent interest in Schnitzer-PMS. Prudential declined the offer.

Although the record shows that Ballard introduced Schnitzer to Kanter sometime between 1971 and 1976, it is not clear whether the introduction was made before or after Schnitzer proposed to give Prudential 50 percent of the Schnitzer-PMS stock. After Prudential declined Schnitzer's offer and prior to September 1976, Schnitzer and Kanter began discussing Kanter's purchasing 50 percent of Schnitzer-PMS. Kanter indicated that he could obtain additional business for Schnitzer-PMS through his business contacts, including his contacts with the Pritzkers. Before agreeing to the sale of the

stock, Schnitzer confirmed with Ballard that Kanter could bring in business for Schnitzer-PMS.

Kanter and Schnitzer agreed that Schnitzer-PMS would be recapitalized to provide for preferred stock to be issued to Century. The preferred stock was entitled to a preferred dividend equal to the amount of Century's bank loan outstanding on its original purchase of Fletcher Emerson. Century would receive the preferred stock and 52.5 percent of the common stock, and Kanter's client (IRA) would purchase 47.5-percent (51.3 shares) of the common stock for $150,000. Although closing was originally set for October 1976, because of difficulties in finalizing the agreement, closing did not take place until January 1978. IRA paid $50,000 at closing and issued a promissory note for the $100,000 balance.

Schnitzer's primary objective in selling the 47.5-percent Schnitzer-PMS interest to IRA was to acquire business from the Pritzkers and/or Hyatt which he felt could be obtained through Kanter's influence. By early 1978, although Schnitzer-PMS' business, in particular its business with Prudential, had greatly increased, it had not received any business from Hyatt. When such business was not forthcoming, Schnitzer decided that IRA should sell back the Schnitzer-PMS stock. Kanter offered to either sell IRA's stock in Schnitzer-PMS to Century or purchase from Century Development Corp. its stock in Schnitzer- PMS for $3.1 million. In November 1979, Century repurchased the 47.5 percent owned by IRA in July 1979 for $3.1 million, payable over a 10-year period with interest. At the time of the repurchase, approximately $700,000 remained outstanding on the loan for the original purchase of Fletcher Emerson. The payments for the repurchase of the Schnitzer-PMS stock were accumulated in IRA until the formation of Carlco, TMT, and BWK, Inc. In 1984, IRA transferred the funds to the three new corporations in a 45-45-10 ratio, effectively transferring 45 percent to Lisle, 45 percent to Ballard, and 10 percent to Kanter. After 1984, IRA continued to distribute

the installment payments to Carlco, TMT, and BWK, Inc. in the 45-45-10 ratio.

Respondent asserts that Schnitzer used the sale and repurchase of the stock as a means of paying a kickback to Ballard and Lisle for their influence in obtaining business with Prudential. It is argued that the kickback is evidenced by a bargain sale price and an excessive repurchase price. Petitioners argue that the purchase price was not a bargain purchase because at the time of the purchase, Schnitzer-PMS had assets with net book value of approximately $200,000 and 47.5 percent of that amount would be $95,000.

We do not think, however, that net book value of the corporation's assets is an appropriate measure of the value of a service corporation. We note that when the stock was repurchased in 1979 for $3.1 million, the corporation had net assets of $255,581. Additionally, Schnitzer's purchase price of $1.3 million for the Fletcher Emerson stock was based on five times the pretax income of approximately $250,000. Schnitzer-PMS' 1977 pretax income was $451,347. Five times Schnitzer-PMS' 1977 pretax income of $451,347 is approximately $2.2 million. Allowing for the value of the preferred stock liquidation dividend preferences equal to the $1.1 million debt outstanding on Century's original purchase of Fletcher Emerson, the value of Schnitzer-PMS common stock at the time IRA acquired the stock was approximately $1.1 million. IRA acquired 47.5 percent of the common stock with a value of at least $522,500 for $150,000. [FN45] Furthermore, IRA paid $50,000 at closing and issued a promissory note for the $100,000 balance. IRA did not pay the $100,000 until after Schnitzer told Kanter that he wanted to repurchase IRA's Schnitzer-PMS stock. Clearly, IRA's purchase of the Schnitzer-PMS stock was a bargain. Schnitzer sold the stock to IRA at the bargain price in exchange for Kanter's promise to use his influence with his clients, particularly the Pritzkers, to direct business to Schnitzer-PMS. Schott's and Weisgal's relationships to IRA, as well as their contacts, were irrelevant. Schnitzer would

have sold the stock directly to Kanter or to any entity that Kanter wanted to use for the transaction. Moreover, Schnitzer testified that he would have sold the stock for less than $150,000.

With respect to the repurchase price, Schnitzer-PMS' 1978 pretax income was $832,000. When IRA sold the stock back to Schnitzer, approximately $700,000 remained outstanding on the loan for the original purchase of Fletcher Emerson. Based on five times earnings, at the time of repurchase the entire business was worth approximately $4.2 million ($832,000 x 5); allowing for the liquidation and dividend preferences of the preferred stocks the common stock had a value of roughly $3.5 million ($4.2 million--$700,000), and IRA's 51.3 shares of common stock had a value of roughly $1.6 million ($3.1 million x 47.5 percent). [FN46] The Court notes, however, that around the end of 1979 or early 1980, Schnitzer discussed the sale of Schnitzer-PMS to Minneapolis Honeywell for a price between $12 million and $13 million. [FN47] Although Honeywell decided not to purchase Schnitzer-PMS, we think that when Schnitzer agreed to repurchase the Schnitzer-PMS stock from IRA, he thought the stock was worth $3.1 million. Otherwise, he would have sold Century's stock to IRA.

Schnitzer's primary objective in selling the 47.5-percent Schnitzer-PMS interest to IRA was to acquire business from Hyatt which he felt could be obtained through Kanter's influence. Apparently, when Schnitzer negotiated the reacquisition of the stock, he was unaware of the assistance from Ballard or Lisle for additional property management business with Prudential. Thus, although we find that Schnitzer sold the stock to IRA at a bargain price for Kanter's influence, we cannot say that Schnitzer intended the payments to repurchase the stock as kickbacks to Ballard and Lisle.

The flow of the money, however, makes it clear that Kanter agreed to share the money received from the transaction with Ballard and Lisle in exchange for their assistance in

giving more Prudential business to Schnitzer-PMS. The increase in the Prudential business greatly increased the pretax income and, thus, the value of the Schnitzer-PMS stock. IRA, as with the other transactions involving the Five, held for the benefit of Ballard, Lisle, and Kanter the funds received from the repurchase of its stock in Schnittzer-PMS, and distributed the funds to the individuals through Carlco, TMT, and BWK, Inc.

5. The Eulich/Essex Arrangement

The final arrangement involved petitioners, Eulich, and Connolly. Eulich was a real estate developer and had known Ballard and Lisle since at least 1965. Eulich dealt with Ballard and Lisle in connection with Prudential's financing his development of real estate. Eulich and Kanter had also known each other since the late 1960's or early 1970's and had had many business dealings with each other. Eulich owned a hotel management company called Eulich-Management. Connolly was an employee of another management company that managed Prudential's Gateway Hotel. Connolly was employed as the in-house manager of Prudential's Gateway Hotel. In 1981, Connolly threatened to quit because he wanted an increase in his compensation. Prudential began discussing giving the management contract to Connolly.

Ballard introduced Connolly to Eulich. Kanter, Eulich, and Connolly then organized two corporations, a hotel management company called Gateway Corp. and Essex Corp. (incorporated in 1981). Eulich provided $10,000 for the initial capitalization of Gateway Corp. Connolly was issued all of the stock of Gateway Corp., but granted Essex Corp. a 10-year option to purchase 80 percent of the stock.

By February 1, 1982, Gateway Corp. entered into management contracts with Prudential to operate the Gateway Hotel and the Midland Hotel (another hotel owned by Frudential). Gateway Corp. was required by Prudential to provide financial reports on the Gateway Hotel's operations. The full-time employment of personnel to

perform these and other required services would have been uneconomical, since Gateway Corp. would be managing only one or two hotels. Therefore, Eulich agreed that employees of Eulich-Management would provide these services for Gateway Corp.

Eulich, Kanter, and Connolly also formed the Essex partnership (organized effective January 1, 1982). Eulich-Management held a 47.5-percent interest in Essex, Connolly a 5-percent interest, and Kanter's entities IRA and Holding Co. held the remaining 47.5 percent (26.125 percent and 21.375 percent, respectively).

The Essex partnership entered into "Representation and Marketing" agreements with Eulich-Management and Gateway Corp., effective January 1, 1982. The Eulich-Management/Essex agreement required Eulich-Management to pay to Essex 30 percent of its management fees from its operation of the Madison Hotel and 43 percent of the fees from its operation of the Allentown Hilton. The Gateway Corp./Essex agreement required Gateway Corp. to pay to Essex 75 percent of Gateway Corp.'s management fees from the operations of the Gateway Hotel and the Midland Hotel.

The Essex partners agreed that Gateway Corp. and Eulich Management generally would pay the same amount of fees to the Essex partnership. The partnership's specified percentage of fees under each consulting and fee participation agreement could be adjusted and modified if a significant change occurred with respect to the compensation that Gateway Corp. or Eulich-Management received under a particular hotel management contract. Substantially all of Essex's income came from Gateway Corp. and Eulich-Management.

From 1982 to 1988, Essex received $1,334,601 in commission fee payments from Gateway Corp. and $1,563,412 from Eulich-Management. In 1989, Essex received a total of $293,261 from Eulich-Management and Gateway Corp. From 1982 to 1989, Essex distributed $788,452 to IRA, $645,028 to

Holding Co., $150,899 to Connolly, and $1,433,551 to Eulich-Management.

IRA accumulated the money paid to it by Essex until 1983. In 1983, IRA began distributing the money to Ballard, Lisle, and Kanter through Carlco, TMT, and BWK, Inc., in the 45-45-10 ratio. On December 31, 1984, IRA transferred its partnership interest in Essex to Carlco, TMT, and BWK, Inc., in the 45-45-10 ratio. IRA did not inform the Essex partnership of the transfer and continued to receive the payments from Essex and then transferred the payments to Carlco, TMT, and BWK, Inc.

Essex had no real business purpose. It had no office, equipment, or employees and did not perform any services under the "Representation and Marketing" agreements with Eulich-Management and Gateway Corp.

Eulich's relationship with Ballard, Lisle, and Kanter was longstanding. Lisle's son was employed by one of Eulich's Vantage companies. The Court is convinced that Eulich agreed that Eulich-Management would participate in the Essex arrangement and provide services to Gateway Corp. as payment to Kanter, Lisle, and Ballard for their influence with respect to other business directed to Eulich and his corporations. Eulich testified at trial that he caused Eulich-Management to participate in the Essex partnership because he expected that Kanter might eventually help Eulich-Management obtain management contracts for larger hotels.

Although Connolly was an excellent hands-on hotel manager, he had no experience with the financial or reporting aspects of managing a hotel. He participated in the formation of Gateway Corp. and Essex and the financial arrangement because he wanted more money than he had been receiving from the company managing the Gateway Hotel. His participation in this activity was solely at the direction of Ballard, Lisle, and Kanter. Connolly was nothing more than a pawn of Kanter, Ballard, and Lisle.

Employees of Eulich-Management performed record-keeping and reporting services for Gateway Corp., but

Eulich-Management did not charge Gateway Corp. for these services. At least 50 percent of the money received by the Essex partnership came from Eulich-Management, which in turn received only 47.5 percent of the distributions. Under the arrangement, there was no way Eulich-Management could ever make a profit by participating in the Essex arrangement. IRA and Holding Co., on the other hand, never contributed any money to the Essex partnership and never provided any services to Gateway Corp. or the Essex partnership, yet together IRA and Holding Co. received 47.5 percent of the distributions from Essex.

Eulich-Management received back in the form of partnership distributions most of the payments it made to Essex. The net effect was that 75 percent of the management fees Prudential paid to Gateway Corp. was distributed through Essex to Holding Co. and IRA, and finally to Kanter, Ballard, and Lisle. The "Representation and Marketing" agreements thus merely served to disguise payments from the operation of the Gateway and Midland hotels to Kanter, Ballard, and Lisle.

The income to IRA was offset with losses reported on its consolidated return. The entire convoluted arrangement served to conceal Kanter, Ballard, and Lisle's interest in the operations of the hotels from Prudential and to avoid tax.

As with payments made by other members of the Five to IRA, the payments were accumulated in IRA until the formation of Carlco, TMT, and BWK Inc. The funds accumulated in IRA were distributed in the 45-45-10 ratio to Carlco, TMT, and BWK, Inc., and thus, distributed to Lisle, Ballard, and Kanter. The record does not show that the payments made to Holding Co. were distributed to anyone other than Kanter. On the basis of the evidence clearly established in the record, we conclude that Kanter, Ballard, and Lisle agreed that Kanter would receive for his services 100 percent of the Essex payments made to Holding Co. and 10 percent of the Essex payments made to IRA and that Ballard and Lisle each would receive for their services 45

percent of the Essex payments made to IRA.

6. Conclusion

At trial, all the witnesses associated with the Five explicitly denied that the payments described were "kickbacks" or "payoffs" for Ballard and/or Lisle's help in steering business to them. Those witness did confirm, however, that they entered into these arrangements in exchange for Kanter's influence in obtaining business. Furthermore, it is clear from the record that Kanter, Ballard, and Lisle agreed to share and did share the money from the Prudential transactions in a 45-45-10 split.

Although some of the Prudential payments and transactions were finalized after Ballard and Lisle left Prudential, the transactions began long before Ballard and Lisle left Prudential. The payments had their genesis in transactions with which Ballard and Lisle were both familiar and in which they were directly or indirectly involved while they held executive positions with Prudential. The transactions, even if occurring after Ballard and Lisle left Prudential, were simply a continuation of what was laid out and planned in earlier years.

Thus, we find that 70 percent of the payments from Hyatt to KWJ Corp., all of the payments by Frey to Zeus, all of the payments from Schaffel connected with Prudential transactions and made to IRA, the bargain element in the sale of the Schnitzer-PMS stock to IRA, and all of the Essex distributions to IRA are attributable to services provided by Ballard, Lisle, and Kanter. We further find that the payments made by Frey to Holding Co., the payments made by Schaffel to IRA and Holding Co. from transactions not involving Prudential, and the distributions from Essex to Holding Co. are attributable solely to services provided by Kanter.

B. Overview of the Law

Gross income includes all income from whatever source derived. See sec. 61(a). The principle that income is taxed to the person who earned it is basic to our income tax system.

See United States v. Basye, 410 U.S. 441, 450, 93 S.Ct. 1080, 35 L.Ed.2d 412 (1973); Commissioner v. Culbertson, 337 U.S. 733, 739- 740, 69 S.Ct. 1210, 93 L.Ed. 1659 (1949); Lucas v. Earl, 281 U.S. 111, 115, 50 S.Ct. 241, 74 L.Ed. 731 (1930). In United States v. Basye, supra at 450, the Supreme Court stated: "The principle of Lucas v. Earl, that he who earns income may not avoid taxation through anticipatory arrangements no matter how clever or subtle, has been repeatedly invoked by this Court and stands today as a cornerstone of our graduated income tax system". (Emphasis supplied.)

No device or arrangement, no matter how shrewdly or cunningly contrived, can make earnings from personal services taxable to anyone other than the real earner. This principle has been applied to various income-splitting devices, e.g., anticipatory assignments of income to family members (Lucas v. Earl, supra); family trusts (Helvering v. Clifford, 309 U.S. 331, 60 S.Ct. 554, 84 L.Ed. 788 (1940)); family partnerships (Commissioner v. Tower, 327 U.S. 280, 66 S.Ct. 532, 90 L.Ed. 670 (1946); Lusthaus v. Commissioner, 327 U.S. 293, 66 S.Ct. 539, 90 L.Ed. 679 (1946); Commissioner v. Culbertson, supra; Alexander v. Commissioner, 194 F.2d 921 (5th Cir.1952)); and shareholder- corporation arrangements (Gregory v. Helvering, 293 U.S. 465, 55 S.Ct. 266, 79 L.Ed. 596 (1935); Griffiths v. Commissioner, 308 U.S. 355, 60 S.Ct. 277, 84 L.Ed. 319 (1939); Higgins v. Smith, 308 U.S. 473, 60 S.Ct. 355, 84 L.Ed. 406 (1940); Moline Properties, Inc. v. Commissioner, 319 U.S. 436, 63 S.Ct. 1132, 87 L.Ed. 1499 (1943); Commissioner v. Court Holding Co., 324 U.S. 331, 65 S.Ct. 707, 89 L.Ed. 981 (1945)).

If, as in these cases, the issue involves income paid to corporations, we encounter the important policy of the law favoring recognition of a corporation as a legal person and economic actor. If corporations are formed for substantial business purposes, or are actually engaged in substantial business activities, the corporate forms must be recognized for tax purposes. See Moline Properties, Inc. v. Commissioner, supra. On the other hand, if the subject

entities are unreal or shams, the corporate form must be disregarded for tax purposes. See Higgins v. Smith, supra. A finding that a corporation is a sham allows the Commissioner to disregard the corporation altogether for tax purposes. See Haberman Farms, Inc. v. United States, 305 F.2d 787 (8th Cir.1962); James Realty Co. v. United States, 280 F.2d 394 (8th Cir.1960). A finding that a corporation is not a sham, however, does not preclude reallocation under the assignment of income doctrine. It is still possible that a taxpayer could assign the receipt of income earned to a viable corporation in an attempt to avoid the tax liability for that income. This would violate the general principle that income is taxable to the person who earns it. See United States v. Basye, supra at 449-450; Helvering v. Horst, 311 U.S. 112, 119, 61 S.Ct. 144, 85 L.Ed. 75 (1940); Lucas v. Earl, supra at 114-115. Additionally, section 482 authorizes the Secretary to apportion or allocate income between organizations controlled by the same interests if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such organizations.

1. Sham Corporations

Respondent asserts that IRA, its subsidiaries Carlco, TMT, and BWK, Inc., and Holding Co. were sham or dummy corporations that should not be recognized as separate taxable entities. We agree.

Although taxpayers have the right to mold their business transactions in such a manner as to minimize the incidence of taxation, United States v. Cumberland Pub. Serv. Co., 338 U.S. 451, 70 S.Ct. 280, 94 L.Ed. 251 (1950), the Government is not required to acquiesce in the form chosen by taxpayers for doing business. If the form is unreal and a sham, the fiction may be disregarded for purposes of the tax statutes. See Higgins v. Smith, supra; Gregory v. Helvering, supra . The question whether a corporation is genuine or a sham is one of fact. See Noonan v. Commissioner, 451 F.2d 992, 993 (9th Cir.1971), Shaw Constr. Co. v. Commissioner, 323 F.2d 316,

321 (9th Cir.1963).

In Moline Properties, Inc. v. Commissioner, supra at 438-439, the Supreme Court established the following test for determining whether a corporation will be recognized as a separate taxable entity:

The doctrine of "corporate entity" fills a useful purpose in business life. Whether the purpose be to gain an advantage under the law of the state of incorporation or to avoid, or to comply with the demands of creditors or to serve the creator's personal or undisclosed convenience so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a "separate taxable entity". * * * [Fn. refs. omitted.]

Thus, if the corporations were organized for substantial business purposes, or actually engaged in substantial business activities, their corporate forms must be recognized for tax purposes.

To be recognized, a corporation must be organized for a substantial "business" purpose in the ordinary meaning. See National Investors Corp. v. Hoey, 144 F.2d 466, 468 (2d Cir.1944). "[E]scaping taxation is not 'business' in the ordinary meaning". Id. Thus, a corporation organized for the purpose of avoiding tax is not organized for substantial business purposes.

It is clear from the evidence in these cases that the multiple corporations, as well as the trusts and partnerships, organized by Kanter were not organized for any substantial business purpose but were organized primarily to obtain tax benefits.

Kanter routinely created "shelf" corporations that remained inactive until he needed a vehicle to channel payments from his various schemes. At trial, Kanter admitted that Carlco, TMT, and BWK, Inc., were "shelf" corporations. Thus, any business purposes set forth in the articles of incorporation were merely gestures without substance.

Furthermore, Kanter routinely created various corporations,

partnerships, and trusts with similar names; for example, Cedilla Co ., Cedilla Investment Co., Investment Research Associates, Ltd. (formerly Cedilla Co.), Cedilla Co. (formerly Arba Investments Inc.), and Cedilla Trust; KWJ Corp. and KWJ Co. partnership; Essex Corp. and Essex Partnership. As a result of the intended confusion created by similar names, Kanter could substitute one entity for another. For example, after KWJ Corp. was liquidated, the payments from Hyatt to KWJ Corp. were simply treated as payments to the KWJ Co. partnership. Hyatt never knew about the change until about 1992.

Moreover, assuming IRA's predecessor Cedilla Co. (Old Cedilla Co.) had been incorporated for the purpose of brokering real estate (a valid business purpose [FN48]), we cannot attribute the purpose for the formation of Old Cedilla Co. to IRA. Originally, Keating owned the common stock of Old Cedilla Co., and Schott owned the preferred class A preferred stock.

In 1975, the same year Weaver agreed to sell KWJ Corp. to Kanter, Keating's 1,000 shares of common stock of Old Cedilla Co. were exchanged for 500 shares of class B preferred stock, [FN49] and Weisgal as trustee of the Bea Ritch trusts acquired 1,000 shares of the common stock. Schott continued to hold the class A preferred stock in Old Cedilla Co. to enable Old Cedilla Co. to qualify for a corporate broker's license.

In 1978, Old Cedilla Co.'s name was changed to IRA. When Old Cedilla Co.'s name changed, IRA acquired 1,000 shares of Arba and changed the name of Arba to Cedilla Co (New Cedilla Co.). IRA's end of year balance sheet indicates that IRA's 1,000 shares of Cedilla Co. were the only shares outstanding.

In 1983, IRA made a journal entry to show that IRA redeemed Schott's 500 shares of IRA class B preferred stock in exchange for IRA's 1,000 shares of its Cedilla Co. stock. Schott thought that, when Cedilla Co.'s name was changed to IRA, she acquired another company and the name of that

corporation was changed to Cedilla Co. She did not know that she had owned any of the stock of IRA after the name change. She testified that she owned New Cedilla Co. and that she conducted her real estate brokerage business individually as well as through IRA and New Cedilla Co. The name change occurred in 1978, the same year IRA purchased the stock of Schnitzer-PMS and the payments to IRA related to the Prudential transactions began. In 1979, when IRA acquired the stock of KWJ Corp., Schaffel began splitting commissions with Kanter, and Century repurchased IRA's Schnitzer-PMS stock. When Cedilla Co.'s name was changed to IRA, whatever the purpose Cedilla Co. was originally formed to pursue, it is evident that purpose went along with the name to a new Cedilla Co.

We find that the corporations and entities were not organized for any valid business purposes.

A corporation is not treated as carrying on a business merely because it engages in certain corporate formalities, such as holding corporate meetings, adopting bylaws, electing officers and directors, issuing securities and keeping separate books. See Aldon Homes, Inc. v. Commissioner, 33 T.C. 582, 600-601, 1959 WL 972 (1959). In order to be treated as carrying on a business, in addition to engaging in corporate formalities, the corporation must hold itself out to unrelated third parties and engage in substantial business activities. See Skarda v. Commissioner, 250 F.2d 429, 434-435 (10th Cir.1957), affg. 27 T.C. 137, 1956 WL 558 (1956). Further, a corporation is not treated as carrying on a business if its activities, such as executing contracts and filing tax returns, are merely "empty gestures" rather than substantial transactions. Kimbrell v. Commissioner, 371 F.2d 897, 901-902 (5th Cir.1967), affg. T.C. Memo.1965-115.

The following factors lead us to the conclusion that IRA did not carry on any business.

We first observe that the original Cedilla Co. paid minimal salaries or wages in 1977 ($986) and 1978 ($5,051). After the name change in 1979, IRA paid minimal salaries or wages

only in 1981 ($9,969), and 1982 ($26,079) and paid no salaries or wages in any other year. In fact, there is no evidence that IRA had any employees other than bookkeepers who also performed bookkeeping services for the multitude of other Kanter entities. Although the original Cedilla Co. paid substantial commissions and consulting fees from 1976 to 1979, after the name change, IRA paid commissions only in 1981 ($115,400) and in 1985 ($4,000) and paid consulting fees only in 1982 ($29,000).

The original Cedilla Co. paid officer's fees in 1977 ($19,300) and 1978 ($15,000). After the name change, IRA did not pay any officer's or director's fees (except the $12,500 payment made to Ballard).

Furthermore, there is no evidence that the commissions, consulting fees, officer's fees, or director's fees were properly characterized as such payments or paid for services provided to the corporations. For example, petitioners assert that Ballard was never a director of IRA and that the $12,500 payment to Ballard was not in fact a director's fee. KWJ Corp. and KWJ Co. partnership paid Ballard's and Lisle's children consulting fees, yet the children never provided any services for the payments.

Additionally, there is no evidence that any of IRA's income was attributable to Schott's real estate activity. Schott could not remember exactly what she did for IRA. She merely signed documents without any real knowledge of the transactions involved. When IRA redeemed Schott's 500 shares of IRA class B preferred stock in 1983, IRA no longer qualified to hold a corporate broker license.

The payments of development fees from Frey and the BJF partnership were not related to any investment IRA and Holding Co. may have made in any of Frey's condominium conversion projects.

We conclude that the corporations did not carry on substantial business activity in the ordinary meaning.

Finally, even if we were able to find some modicum of business activity, petitioners and other parties to the various

transactions did not recognize any of the corporations or entities as valid separate entities or true parties in interest to the various transactions. Some of the individuals involved in the transactions with Kanter had never heard of IRA, and those that had, considered IRA to be Kanter.

Around 1992, Kanter attempted to have Hyatt send the payments to the KWJ Co. partnership instead of to Weaver. While Kanter provided Hyatt with documents showing that KWJ Corp. had been sold to IRA, liquidated, and the contract rights assigned to KWJ Co. partnership, Hyatt refused to do so without Weaver's consent, which had not been attained at the time of trial. Hyatt continued to send the payments to Weaver.

After Lisle began working for Travelers, although Schaffel's agreement was purportedly with IRA, he sent payments from Travelers deals to Holding Co. If IRA, rather than Kanter, had been the true party in interest and had been Kanter's client, the payments for the Travelers deals would have been paid to IRA.

A comparison of the business records of IRA, Administration Co., Int'l Films, Holding Co., and HELO illustrates the sham nature of the entities. Kanter completely controlled IRA, Holding Co., Administration Co., HELO, Int'l Films, and the various trusts. He had unrestricted power over the commingled funds and was in a position to determine and direct the payments from outside sources to the various entities. He routinely used the funds for his own benefit. He routinely shifted accounts between entities with no documentation to establish a rationale for such transfers. He created phony loans that were eventually written off, and then he or the corporations took bad debt deductions to offset additional income.

Similarly, Lisle, Ballard, and Kanter failed to recognize any separate identity of Carlco, TMT, and BWK, Inc. Petitioners assert that Lisle, Ballard, and Kanter were only the respective managers of the assets of Carlco, TMT, and BWK, Inc., and claim that the preferred stock issued to their family

trusts had minimal value. The record clearly shows, however, that petitioners' control over the assets of the corporations went far beyond that of a manager. Petitioners used the funds for their personal benefit. From 1984 to 1986, Ballard transferred $16,599 to himself that was recorded as a receivable on TMT's books. In 1987, Ballard transferred the St. Francis Arkansas land owned by TMT to himself and recorded the transfer as a sale. He did not pay for the land but recorded a receivable of $100,000 as owed by him on TMT's books. In 1987, TMT funds also were used to pay $20,344 to the Fairfield Plantation Company, Ballard's S corporation. The payment was recorded as a receivable owed by Ballard. In 1989, Ballard distributed $10,000 to himself from TMT and increased his receivable to $146,943. In addition, Ballard distributed $160,000 of TMT's funds to his wife, $122,900 to the Seabright Trust, $10,080 to the Seabright Corp., all recorded as receivables. Ballard distributed $19,000 to Ficom (Melinda Ballard's sole proprietorship) that TMT later wrote off as a worthless investment. Ballard and his wife referred to farms owned by TMT as their farms.

Kanter took $400,000 out of BWK, Inc. and recorded the distribution as a receivable. Lisle used $3,000 of Carlco's funds to pay a receivable on the books of Administration Co. The payment did not create a receivable on Carlco's books. When receivables were recorded for funds taken out of the corporations, there was no intention or expectation that the funds would be repaid, and there was never any attempt to collect the receivables until the IRS began auditing petitioners' returns.

Petitioners used the corporations' partnership, KWJ Co., to distribute money to the Ballard and Lisle children in the guise of consulting fees. The children never performed any services for the payments.

Petitioners maintained possession of the corporations' assets and records. The addresses given for Carlco and TMT were the addresses of Lisle's and Ballard's residences. When Lisle

lived in Connecticut, the records were maintained in Connecticut; when he moved to Texas, the records and accounts were maintained in Texas.

Ballard and Lisle gave family members signatory authority over the corporate accounts. Mary Ballard had signatory authority over TMT's Wells Fargo Bank account. Donna Lisle and Lisle's brother had signatory authority over Carlco's Goldman Sachs account. Donna Lisle had signatory authority over Carlco's North Dallas bank account.

Petitioners assert that the only interest they had in Carlco, TMT, and BWK, Inc., was the preferred stock issued to the family trusts and that the stock had minimal value. The certificates of incorporation of Carlco, TMT, and BWK, Inc. authorized each corporation to issue 1,000 shares of 10-cent par value common stock. Certificates of amendment, filed in December 1983, authorized the corporations to issue 11,000 shares of stock comprised of 10,000 shares of 1- cent par value preferred stock and 1,000 shares of 10-cent par value common stock. The amended certificates granted each corporation's board of directors authority to fix the preferences of the preferred shares. The record does not contain any evidence of resolutions by the board of directors of any of the three corporations setting preferences or limitations on the preferred stock.

Petitioners point to the following preferences and other characteristics printed on the back of the stock certificates to support their assertion that the preferred stock of Carlco, TMT, and BWK, Inc. issued to the family trusts had minimal value:

1. One vote per share.

2. Dividends payable only when, if, and as declared at a maximum rate of 10 percent per annum after 1990. Dividends are non-cumulative.

3. Redemption by company at any time upon 10 days notice at 105 percent. 4. Priority on liquidation equal to original purchase price per share.

5. Shares are not convertible into common stock.

Petitioners claim that the certificates prove that the preferred shares could not be worth more than approximately $1,650, which could only be realized upon liquidation or upon redemption of the shares. We disagree. First, in their briefs, petitioners inserted "of par" into the redemption rights to read "Redemption by company at any time upon 10 days notice at 105 percent of par." The preferred stock could instead be redeemable for 105 percent of, e.g., the retained earnings. Similarly, with respect to liquidation rights, "priority on liquidation equal to original purchase price per share" is also subject to multiple interpretations. The shares could be entitled to the original purchase price first but also allowed to share with the common stock in the remaining assets. Original purchase price could include a value set for the uncompensated services of the manager (Ballard, Lisle, and Kanter). That value could be tied to the retained earnings of the corporations or at an annual amount. Without a resolution by the board of directors setting forth preferences, we find the preferences reflected on the certificates to be ambiguous. Petitioners failed to produce any corporate resolution. We can only 'nfer that the resolutions contradict petitioners' assertions. Finally, the record establishes that Kanter was not restrained by corporate formalities including preferences, stock ownership, asset ownership, etc.

Kanter claims that Carlco's preferred stock was issued to Lisle's family trust to give Lisle more control and discretion with respect to Carlco's investments. We fail to see how stock that does not have voting control could provide such control or discretion with respect to the assets of the corporations. Lisle, Ballard, and Kanter, respectively, had unrestricted control of the assets of Carlco, TMT, and BWK, Inc. We think that fact is a strong indicator of the true owners of the assets.

On the basis of the record before us, we conclude that Kanter personally diverted payments of compensation, including those made by the Five for his, Ballard's, and Lisle's services

and influence, through IRA, Holding Co., and their subsidiaries. Petitioners formed and utilized all the corporations as a way to conceal their true income for the years at issue. The record is clear that petitioners used all of these accounts as parts of incorporated or unincorporated pocketbooks. The corporations whose names were on the various accounts did not earn the taxable amounts attributed to those accounts.

A taxpayer cannot expect the Commissioner to recognize the separate identity of an entity where the taxpayer himself so blatantly ignores any separate existence. Nor should the courts require the Commissioner to do so.

On the record presented to us, we find that IRA, Holding Co., their subsidiaries, including Zeus, Zion, Carlco, TMT, and BWK, Inc. did not carry on any business and were only the alter egos of Kanter, Lisle, and Ballard. We find the various entities to be pure tax avoidance vehicles. The corporations were nothing more than a few incorporating papers of no significance except when a tax return was due. Petitioners diverted millions of dollars of income. The make-believe corporations were shams and too transparent to accept for tax purposes.

2. Assignment of Income

Even if the corporations that received the payments from the Five had been viable entities, that would not preclude application of the assignment of income doctrine, as a taxpayer could assign income to a corporation that conducts real and substantial business in an attempt to avoid tax. See Haag v. Commissioner, 88 T.C. 604, 611, 1987 WL 49288 (1987), affd. without published opinion 855 F.2d 855 (8th Cir.1988).

Gross income means all income from whatever source derived, including compensation for services, including fees, commissions, and similar items. See sec. 61(a)(1).

Compensation for services is an item of gross income that cannot be effectively assigned to escape the burden of taxation. See Lucas v. Earl, 281 U.S. at 114-115. This Court has upheld reallocations of income from a validly organized

and operated corporation to its shareholder/employee under the assignment of income doctrine. See Bagley v. Commissioner, 85 T.C. 663, 1985 WL 15405 (1985), affd. 806 F.2d 169 (8th Cir.1986); Askew v. Commissioner, T.C. Memo.1985-100, affd. 805 F.2d 830 (8th Cir.1986).

Respondent cites DeVaughn v. Commissioner, T.C. Memo.1983-712, as an example of a similar situation in which the assignment of income doctrine was applied to tax kickback payments to an individual taxpayer who had earned the payments but sought to redirect them to that taxpayer's corporation.

In cases involving viable corporations, we consider all the facts and circumstances to determine the actual earner of income. See Schuster v. Commissioner, 800 F.2d 672 (7th Cir.1986), affg. 84 T.C. 764, 1985 WL 15343 (1985); Fogarty v. Commissioner, 780 F.2d 1005 (Fed.Cir.1986), affg. 6 Cl.Ct. 612 (1984); Leavell v. Commissioner, 104 T.C. 140, 155, 1995 WL 33308 (1995). In determining the proper taxpayer, we consider which person or entity controls the earning of the income, such as:

(1) Whether the individual rather than the corporation or entity that received the income, in fact, controlled the earning of the income, see Vercio v. Commissioner, 73 T.C. 1246, 1980 WL 3859 (1980);

(2) whether the individual performed the services as an agent or employee of the corporation, see Rubin v. Commissioner, 51 T.C. 251, 1968 WL 1522 (1968);

(3) whether the corporate form and the status of the corporation as an actual operating enterprise have been recognized by petitioners;

(4) whether the corporate form and the status of the corporation as an actual operating enterprise have been recognized by the other parties to the transactions giving rise to the income;

(5) whether the form of the transaction served an economic purpose, see Rubin v. Commissioner, supra; and

(6) whether the corporations were formed for the purpose of taking advantage of losses incurred by a separate trade or

business.

The record shows that Kanter was in control of negotiations concerning the amount of commissions and that he earned those commissions by performing the work for them. He directed members of the Five where to make payments. The various entities were entirely subject to Kanter's control: he set up the entities, and he managed the entities in that Meyers, Schott, Weisgal, and Freeman were subject to his control. There is no evidence that IRA, Holding Co., or any of the other entities earned these funds. Petitioners handled the accounts as if they were their own, moving funds around from location to location and using the funds for their personal benefit. This is hardly the behavior that petitioners would exhibit if the funds in the accounts were subject to the control of Weisgal or the various entities.

Kanter did virtually all of the planning and implementing of the transactions. The officers, directors, and trustees signed documents and entered transactions as Kanter directed including issuing and redeeming stock, liquidating corporations, purchasing and selling stock, distributing funds, and executing contracts and agreements. There is very little evidence that IRA or the other entities had anything to do with these transactions other than to be the named recipients of the checks.

Lastly, we note that payments to IRA were distributed to the accounts of Carlco, TMT, and BWK, Inc. of which petitioners and their family members were authorized signatories. If, as petitioners contend, the funds of the corporations did not belong to them, they would have been misappropriating the funds through phony loans. Therefore, we conclude that petitioners were simply using the corporations to receive the funds they had earned. Regardless of where the funds actually went, they were earned primarily through the efforts of petitioners via their contacts with Prudential, Travelers, and the Pritzker family.

In Rubin v. Commissioner, supra, we found that the income was properly taxable to the individual who performed the

services for which payment was made where the individual was not contractually bound to (and in fact did not) render services exclusively to a personal service corporation. In these cases, petitioners were not contractually bound to, nor did they render services for, the corporations.

Ballard, Lisle, and Kanter were not employees of any of the corporations or entities involved in the transactions at issue. Ballard and Lisle were full- time employees of Prudential, Travelers, or Goldman-Sachs. Kanter was a self- employed attorney.

Kanter was not an agent of the corporations. In fact, there is evidence that Kanter in some instances held himself out to members of the Five (in particular Schaffel) as Ballard's and Lisle's agent, referring to them as his "associates". Ballard and Lisle did not claim that they were agents of IRA or any other entity (except to justify the payment Ballard received as a director's fee from IRA while denying he was ever a director).

We have previously discussed the failure of petitioners and other parties to the transactions to recognize the separate existence of the corporations. None of the Five recognized any of the corporate entities as controlling petitioners' performance of services. Even though the payments were made to various corporations, it is clear that the other parties to the transactions viewed IRA, Holding Co., their subsidiaries, and Kanter as one and the same. Although the various agreements at issue were between members of the Five and IRA, Holding Co., or one of their subsidiaries, the record shows that there was virtually no involvement in these arrangements by those corporations; rather, they were agreements with the corporations in name only.

Additionally, assuming IRA was not a sham corporation, the purchase of the KWJ Corp. stock was merely a device to hide the stream of income and accumulate the funds. The transaction itself was a sham. Similarly with the purchase of the Schnitzer-PMS stock, Schnitzer would have sold the stock directly to Kanter. He sold it at a bargain price for

Kanter's services, not for any services from IRA, Weisgal, or Schott. It is also clear from the flow of the installment payments on Schnitzer's repurchase of the stock that IRA either held the stock merely as a nominee for Kanter, Ballard, and Lisle, or agreed to pay the money it received from the Schnitzer-PMS transaction to Ballard, Lisle, and Kanter in exchange for their assistance in giving more Prudential business to Schnitzer- PMS. The increase in the Prudential business greatly increased the pretax income and, thus, the value of the Schnitzer-PMS stock. Hence the gain was attributable to their services. IRA held the profits for the benefit of Ballard, Lisle, and Kanter until it distributed the funds to them through Carlco, TMT, and BWK, Inc. The record is replete with examples of interests that were owned initially by Kanter or an entity and then later declared to have been held by Kanter or the entity as "nominee" for someone else. Thus, we hold that the gain on the sale of the stock is properly taxable to Kanter, Ballard, and Lisle.

The use of numerous corporations was to facilitate the concealment of the payments, and such use was further motivated by the tax benefits to be derived therefrom and for no sound business purpose.

We conclude that the transactions at issue are classic situations for the application of the assignment of income doctrine articulated in Lucas v. Earl, 281 U.S. 111, 115, 50 S.Ct. 241, 74 L.Ed. 731 (1930), and its progeny. The amounts received by the corporations were for services rendered by petitioners to the Five and should be includable in their income under section 61. See United States v. Basye, 410 U.S. 441, 450, 93 S.Ct. 1080, 35 L.Ed.2d 412 (1973).

3. Section 482

Finally, even if the corporations had been viable entities, we do not think respondent's reallocation under section 482 was unreasonable, arbitrary, or capricious.

Section 482 authorizes the Secretary to apportion or allocate income between organizations controlled by the same interests if he determines that such distribution,

apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such organizations. The relevant regulation explains that the purpose of section 482 is to place a controlled taxpayer on a tax parity with an uncontrolled taxpayer, and to ensure that controlling entities conduct their subsidiaries' transactions in such a way as to reflect the "true taxable income" of each controlled taxpayer. Sec. 1.482-1A(b)(1), Income Tax Regs. [FN50]

In order to justify a reallocation under section 482, the Commissioner must find (1) that there are two or more trades, businesses, or organizations, (2) that such enterprises are owned or controlled by the same interests, and (3) that the reallocation is necessary to allocate income among the two or more enterprises in order to prevent evasion of taxes or to properly reflect each enterprise's income. See B. Forman Co. v. Commissioner, 453 F.2d 1144, 1152 (2d Cir.1972), affg. in part, revg. in part 54 T.C. 912, 1970 WL 2219 (1970).

Section 482 was intended to apply and has been applied to cases where the profits of one business have been offset against the losses of another to reduce or escape tax liability. See Ach v. Commissioner, 42 T.C. 114, 1964 WL 1353 (1964), affd. 358 F.2d 342 (6th Cir.1966).

In these cases, there was shifting of profits from one business to another (from petitioners to the various Kanter entities); thus the primary evil that section 482 was designed to prohibit is present. We hold that respondent's reallocation under section 482 was not unreasonable.

4. Conclusion

We have found that 70 percent of the payments from Hyatt to KWJ Corp., all of the payments by Frey to Zeus, all of the payments from Schaffel to IRA, the bargain element in the sale of the Schnitzer-PMS stock to IRA, and all of the Essex distributions to IRA are attributable to services provided by Ballard, Lisle, and Kanter. We further have found that the gain on the sale of the Schnitzer-PMS stock was properly taxable to Ballard, Lisle, and Kanter. Additionally, the

interest income earned on the payments is also properly taxable to Ballard, Lisle, and Kanter. Finally, we have found that the payments by Frey to Zion, the payments by Schaffel to Holding Co, and the distributions from Essex to Holding Co. are attributable to services provided by Kanter.

In addition, we have found that the corporations were shams, and, even if the corporations had been viable entities, petitioners were the true earners of the income, and respondent's allocation under section 482 was not unreasonable, arbitrary, or capricious.

With respect to 70 percent of the payments from Hyatt to KWJ Corp ., all of the payments by Frey to Zeus, all of the payments from Schaffel to IRA, the bargain element in the sale of the Schnitzer-PMS stock to IRA, as well as the gain and interest on the repurchase of the stock, and all of the Essex distributions to IRA, we think the 45-45-10 split is clearly evident. Thus, we hold that the payments, bargain element, gain, and interest are taxable 45 percent to each of Ballard and Lisle and 10 percent to Kanter.

IRA acquired 47.5 percent of the common stock of Schnitzer-PMS Corp. with a value of roughly $522,500 for $150,000. We hold that the bargain element is $372,500 ($522,500--$150,000) and the gain on the sale is $2,577,500 ($3.1 million--$522,500). The gross profit ratio is 83.15 percent ($2,577,500 divided by $3.1 million).

IRA received the following payments of principal and interest on the installment sale of the Schnitzer-PMS Corp. stock:

Year	Payment	Principal	Interest
1979	$150,000	$150,000	--
1980	533,425	211,468	$321,957
1981	534,696	309,308	225,388
1982	361,692	172,441	189,251
1983	361,692	186,655	175,037
1984	361,692	202,042	159,650

1985	361,692	218,696	142,996
1986	361,692	236,724	124,968
1987	361,692	256,217	105,475
1988	361,692	277,360	84,332
1989	840,423	822,841	17,582
Total	4,590,388	3,043,752	1,546,636

The gain on the sale is computed as follows:

Year	Principal	Profit Ratio	Gain
1979	$150,000	.8315	$124,725
1980	211,468	.8315	175,836
1981	309,308	.8315	257,190
1982	172,441	.8315	143,385
1983	186,655	.8315	155,204
1984	202,042	.8315	167,998
1985	218,696	.8315	181,846
1986	236,724	.8315	196,836
1987	256,217	.8315	213,044
1988	277,360	.8315	230,625
Total			1,846,689

In 1989, IRA accepted $822,841 as the final principal payment, reducing the selling price to the total principal payments of $3,043,752. For purposes of computing the 1989 gain, adjusted gross profit on the sale is reduced to $2,521,252 ($3,043,752--$522,500). Thus, the gain recognized in 1989 is $674,563 (the adjusted gross profit $2,521,252 less the $1,846,689 gain recognizable in prior years).

The payments related to these transactions paid by the Five to IRA and its subsidiaries during the years 1978 through 1989 were as follows:

Schnitzer-PMS

Year Hyatt Schaffel Frey Essex Bargain Gain Interest Total
---- ------- -------- -------- ------- ------------------------ ---------

1977 $38,394 - - - - - - $38,394
1978 42,517 - - - $372,500 - - 415,017
1979 119,719 $100,000 - - - $124,725 - 344,444
1980 - 244,920 $127,372 - - 175,836 $321,957 8 70,085
1981 90,070 361,525 105,764 - - 257,190 225,388 1,039,937
1982 172,702 447,450 538,781 $86,212 - 143,385 189,251
1,577,781
1983 172,090 30,981 110,125 78,375 - 155,204 175,037 721,812
1984 186,092 - 103,500 133,238 - 167,998 159,650 750,478
1985 206,790 - 128,763 120,175 - 181,846 142,996 780,570
1986 231,263 - - 80,465 - 196,836 124,968 633,532
1987 229,449 - - 120,698 - 213,044 105,475 668,666
1988 197,348 - - 117,562 - 230,625 84,332 629,867
1989 52,777 - - 51,727 - 674,563 17,582 796,649

The payments related to the Prudential transactions are allocable to Ballard, Lisle, and Kanter in the following amounts for each of the years 1978 through 1989:

Year Total Ballard (45%) Lisle (45%) Kanter (10%)
---- --------- ------------ ---------- ------------
1978 $38,394 $17,277 $17,277 $3,839
1979 415,017 186,758 186,758 41,502
1980 870,085 391,538 391,538 87,009
1981 1,039,937 467,972 467,972 103,994
1982 1,577,781 710,001 710,001 157,778
1983 721,812 324,815 324,815 72,181
1984 750,478 337,715 337,715 75,048
1985 780,570 351,257 351,257 78,057
1986 633,532 285,089 285,089 63,353
1987 668,666 300,900 300,900 66,867
1988 629,867 283,440 283,440 62,987
1989 796,649 358,492 358,492 79,665

With regard to the $213,750 paid by Schaffel to IRA in 1983 related to a Travelers' financing transaction, as well as all payments by the Five to Holding Co, the record does not show that any of these payments were ever distributed to Lisle. We hold that Kanter realized all of the income. Schaffel, Frey, and Essex made the following payments to IRA and Holding Co. during the years 1981 through 1989 that are taxable to Kanter, as follows:

Year Schaffel Frey Essex Total
---- --------- ------- ------- ---------
1981 -- $80,616 -- $80,616
1982 -- -- $70,538 70,538
1983 $213,750 16,200 64,125 294,075
1984 600,000 113,827 109,013 822,840
1985 1,160,000 256,557 98,325 1,514,882
1986 1,003,500 -- 65,835 1,069,335
1987 -- 30,570 98,752 132,322
1988 -- -- 96,188 96,188
1989 -- -- 42,332 42,332

We hold that Ballard's omitted income from the Five for the years before the Court is as follows:

Year Omitted Income
---- --------------
1978 $17,277
1979 186,758
1980 391,538
1981 467,972
1982 710,001
1984 337,715
1987 300,900
1988 283,440
1989 358,492

We hold that Lisle's omitted income from the Five for the

years before the Court is follows:

Year	Omitted Income
1984	$337,715
1987	300,900
1988	283,440
1989	358,492

We hold that Kanter's omitted income from the Five for each of the years before the Court is as follows:

Year	Prudential	Other	Omitted Income
1978	$3,839	--	$3,839
1979	41,502	--	41,502
1980	87,009	--	87,009
1981	103,994	$80,616	184,610
1982	157,778	70,538	228,316
1983	72,181	294,075	366,256
1984	75,048	822,840	897,888
1986	63,353	1,069,335	1,132,688
1987	66,867	132,322	199,189
1988	62,987	96,188	159,175
1989	79,665	42,332	121,997

III. Fraud Additions to Tax and Penalties

A. Positions of the Parties

None of the notices of deficiency issued to Ballard, Lisle, and Kanter determined fraud. At some point in time, respondent saw the need to amend the answers in these cases to assert that petitioners were liable for the fraud additions to tax and penalties and to increase the deficiencies in tax over those determined in the notices of deficiency. The parties and the Court agreed that the amendments to answers would not be filed in each of these cases until the trial commenced on June 13, 1994. Similarly, it was agreed that replies would be filed

at that time. Kanter filed a motion to strike portions of respondent's amendments to answer that alleged increases in deficiencies and fraud with respect to transactions unrelated to payments from the Five.

The Court granted Kanter's motion as follows:

ORDERED that petitioners' motion to strike is granted to the extent of all adjustments in respondent's Amendment to Answer for an increased deficiency in tax and additions to tax as to transactions or events which are not related to or constitute part of the transactions which have been commonly referred to and identified by the parties as the "Prudential Issues" and/or "the Five" and, accordingly, such adjustments and the allegations of such adjustments are hereby stricken from the record of this case and will be excluded from consideration by the Court.

Respondent filed a motion for reconsideration. After a hearing on respondent's motion for reconsideration was held on July 25, 1994, that motion was denied. Ballard and Lisle also filed, and the Court granted, motions to strike portions of respondent's amendments to answer that asserted increases in deficiencies and fraud with respect to transactions unrelated to payments from the Five in their cases. Thus, the issue to be decided is whether Kanter, Ballard, and Lisle are liable for the additions to tax and penalties for fraud related to income from transactions with the Five.

Respondent contends that Kanter, Ballard, and Lisle are liable for the additions to tax and penalties for fraud for the years at issue because they received the income from kickback payments involved in a complex scheme intended to conceal, mislead, or otherwise prevent the collection of taxes.

To the contrary, petitioners contend that they did not receive such income and that respondent has failed to prove by clear and convincing evidence that they are liable for the asserted fraud additions to tax and penalties.

B. Applicable Statutory Provisions

For taxable years 1978 through 1981, section 6653(b) provides for an addition to tax in an amount equal to 50 percent of the underpayment of tax if any part of the underpayment is due to fraud.

For taxable years 1982 through 1985, section 6653(b)(1) provides for an addition to tax in an amount equal to 50 percent of the underpayment of tax if any part of the underpayment is attributable to fraud. Section 6653(b)(2) provides for an addition to tax (in addition to the addition under section 6653(b)(1)) in an amount equal to 50 percent of the interest payable under section 6601 with respect to the portion of the underpayment that is attributable to fraud. For purposes of section 6653(b)(2), interest is computed for the period beginning on the last day prescribed for payment of the underpayment (without regard to extensions) and ending on the earlier of the date of assessment or payment of the tax (the statutory period).

For taxable years 1986 and 1987, section 6653(b)(1)(A) provides for an addition to tax in an amount equal to 75 percent of the portion of the underpayment that is attributable to fraud. Section 6653(b)(1)(B) provides for an addition to tax (in addition to the addition under section 6653(b)(1)(A)) in an amount equal to 50 percent of the interest payable under section 6601 for the statutory period with respect to the portion of the underpayment that is attributable to fraud.

For taxable year 1988, section 6653(b)(1) provides for an addition to tax in an amount equal to 75 percent of the portion of the underpayment that is attributable to fraud. Section 6653(b)(2) provides that, if the Secretary (Commissioner) establishes that any portion of the underpayment is attributable to fraud, the entire underpayment is treated as attributable to fraud, except for any portion that the taxpayer establishes is not attributable to fraud.

For taxable year 1989, section 6663(a) provides for the imposition of a fraud penalty in an amount equal to 75

percent of the portion of the underpayment that is attributable to fraud. Section 6663(b) provides further that, if the Secretary (Commissioner) establishes that any portion of the underpayment is attributable to fraud, the entire underpayment is treated as attributable to fraud, except for any portion that the taxpayer establishes is not attributable to fraud.

C. General Legal Principles Relating to Civil Fraud

The Commissioner bears the burden of proof with respect to the additions to tax and penalties for fraud, and that burden must be carried by clear and convincing evidence. See sec. 7454(a); Rule 142(b); Rowlee v. Commissioner, 80 T.C. 1111, 1123, 1983 WL 14844 (1983).

Respondent must establish each element of fraud by clear and convincing evidence in each of the years at issue. See sec. 7454(a); Rule 142(b); Smith v. Commissioner, 926 F.2d 1470, 1475 (6th Cir.1991), affg. T.C. Memo.1989- 171; Traficant v. Commissioner, 884 F.2d 258, 263 (6th Cir.1989), affg. 89 T.C. 501, 1987 WL 45156 (1987). In view of our order granting petitioners' motions to strike portions of respondent's amendments to answers, respondent must prove by clear and convincing evidence for each of the years in issue (1) the existence of an underpayment of tax each year attributable to transactions related to the Five, and (2) that the underpayment of that tax is due to fraud. However, if respondent establishes that there are underpayments of tax from transactions related to the Five that are attributable to fraud, the amount of the addition under section 6653(b) for 1978 through 1981 and under section 6653(b)(1) for 1982 through 1985 is equal to 50 percent of the entire underpayment of tax, including any portion of the underpayment not related to transactions related to the Five. Additionally, if respondent satisfies his burden for 1988 and 1989, the amount of the addition or penalty is equal to 75 percent of the entire underpayment, unless petitioners establish that any portion of an underpayment (resulting from the other issues decided in

these cases) is not attributable to fraud.

D. Underpayments of Tax

Respondent must first prove by clear and convincing evidence that Ballard, Lisle, and Kanter each underpaid their taxes for each of the years at issue on income attributable to transactions related to the Five.

Section 61(a) defines gross income to include "all income from whatever source derived". In addition, the Supreme Court has determined that gross income includes all " 'accessions to wealth, clearly realized, and over which the taxpayers have complete dominion" ', including illegal earnings. James v. United States, 366 U.S. 213, 219, 81 S.Ct. 1052, 6 L.Ed.2d 246 (1961) (quoting Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 431, 75 S.Ct. 473, 99 L.Ed. 483 (1955)); accord Rutkin v. United States, 343 U.S. 130, 137-138, 72 S.Ct. 571, 96 L.Ed. 833 (1952); Ianniello v. Commissioner, 98 T.C. 165, 173, 1992 WL 31236 (1992).

We have held that the payments made by the Five to IRA related to the Prudential transactions are taxable 45 percent each to Ballard and Lisle and 10 percent to Kanter and the remaining payments made to IRA and Holding Co. are taxable 100 percent to Kanter. Our holding is supported by clear and convincing evidence in the record.

Kanter entered into arrangements pursuant to which he would use his business and professional contacts, including his relationship with Ballard and Lisle, to assist members of the Five in obtaining business opportunities or in raising capital for business ventures. In exchange for his services, Kanter received or shared in certain fees. Kanter established a complex organization of corporations, partnerships, and trusts to receive, distribute, disguise, and launder the payments from these arrangements. The payments were made to entities controlled by Kanter and then distributed through various means to Ballard, Lisle, and Kanter, their family members, or to entities established for the benefit of their families.

Eulich, Frey, Schnitzer, and Schaffel (members of the Five

who were involved in the transactions and who testified as witnesses in these cases) each confirmed that they entered into the arrangements in exchange for Kanter's using his business connections and influence to direct business to them. There is no doubt that the payments were made for Kanter's services and, therefore, are income to him. The record clearly shows that out of the payments made to IRA, Kanter agreed to pay (and did pay) to each of Ballard and Lisle 45 percent of the payments related to the Prudential transactions, and that he did not share any of the payments unrelated to the Prudential transactions with Ballard and Lisle or anyone else.

Furthermore, the record establishes beyond any doubt that Ballard and Lisle received the benefit of the payments related to the Prudential transactions. Some of those payments were distributed to them directly or indirectly through their family members and their family trusts. Some of the payments were distributed to Ballard and Lisle through various Kanter-created "sham" entities and were recorded as loan receivables. Others were payments characterized as consulting fees made to their adult children by KWJ Corp. and KWJ Co. partnership.

Kanter entities made the following "loans" to Ballard, his family members, and entities established for the benefit of Ballard's family members:

Ballard Loans

Lender	Year	Distributee	Amount
Int'l Films	1974	CMB Cinema Trust	$10,000
Int'l Films	1975	CMB Cinema Trust	21,500
Int'l Films	1975	CMB Cinema Trust II	12,500
Int'l Films	1976	CMB Cinema Trust	8,200
Int'l Films	1976	CMB Cinema Trust	19,000

Int'l Films 1976 CMB Cinema Trust II 1,100
Int'l Films 1977 CMB Cinema Trust 2,200
Int'l Films 1977 CMB Cinema Trust II 3,400
Int'l Films 1978 CMB Cinema Trust 3,000
Int'l Films 1978 Ballard 9,500
Int'l Films 1979 Ballard 8,784
HELO 1980 Summit Trust 85,000
HELO 1981 Summit Trust 20,700
Int'l Films 1981 CMB Cinema Trust 4,000
IRA 1982 Ballard 160,400
IRA 1983 Ballard 500
Administration Co. 1983 Seabright Trust 11,300
Administration Co. 1984 Ballard 10,000
Administration Co. 1984 Seabright Corp. 25,840
TMT 1985 Mary Ballard 160,000
Administration Co. 1988 Seabright Corp. 5,000

Kanter entities made the following "loans" to Lisle, his family members, and entities established for the benefit of Lisle's family members:

Lisle Loans

Lender	Year	Distributee	Amount
Int'l Films 1974	RWL Cinema Trust		$15,000
Int'l Films 1975	RWL Cinema Trust II		20,000
Int'l Films 1975	Lisle		10,000
Int'l Films 1976	RWL Cinema Trust		5,000
Int'l Films 1976	RWL Cinema Trust II		18,000
Int'l Films 1977	RWL Cinema Trust II		5,000
Int'l Films 1978	Lisle		9,500
Int'l Films 1978	RWL Cinema Trust II		3,750
Int'l Films 1978	RWL Cinema Trust II		4,469
Int'l Films 1979	Lisle		8,784

Int'l Films 1979 RWL Cinema Trust II 3,000
Int'l Films 1980 RWL Cinema Trust II 250
Int'l Films 1981 RWL Cinema Trust II 2,750
Int'l Films 1982 RWL Cinema Trust II 2,320
Int'l Films 1983 RWL Cinema Trust II 3,000
HELO 1983 Basking Ridge Trust 95,000
IRA/Int'l Films 1983 Lisle 3,000
Int'l Films 1984 RWL Cinema Trust II 3,000
Administration Co. 1985 RWL Cinema Trust II 3,000
Int'l Films 1986 RWL Cinema Trust II 3,000
Administration Co. 1987 RWL Cinema Trust II 2,463
IRA 1988 RWL Cinema Trust II 6,000
BWK 1989 RWL Cinema Trust II 3,000
BWK 1990 RWL Cinema Trust II 2,969

Generally, borrowed funds are not included in a taxpayer's gross income "because the taxpayer's obligation to repay the funds offsets any increase in the taxpayer's assets". United States v. Centennial Sav. Bank FSB, 499 U.S. 573, 582, 111 S.Ct. 1512, 113 L.Ed.2d 608 (1991); accord Moore v. United States, 412 F.2d 974, 978 (5th Cir.1969); United States v. Rochelle, 384 F.2d 748, 751 (5th Cir.1967). The hallmarks of a loan are: (1) Consensual recognition between the borrower and the lender of the existence of the loan, i.e., the obligation to repay; and (2) bona fide intent on the part of the borrower to repay the funds advanced. See Collins v. Commissioner, 3 F.3d 625, 631 (2d Cir.1993), affg. T.C. Memo.1992-478.
There was no loan agreement between the various Kanter entities and Ballard or Lisle. There was never any attempt to collect on the receivables until after the IRS began questioning the bona fides of the loans. By that time the loans had already been written off as worthless. Even then Ballard and Lisle denied that they had any obligation to repay. There is no doubt that the distribution payments to Ballard and Lisle were not loans.
Similarly, there is no doubt that the payments made by KWJ Corp. and the KWJ partnership to Ballard and Lisle's adult

children were not for services rendered by the children. From 1982, KWJ Corp. and the KWJ Co. partnership paid the Lisle and Ballard children the following amounts as consulting fees:

	Lisle Children		Ballard Children	
Year	Thomas Lisle	Amy Albrecht	Melinda Ballard	Karen Hart
1982	$7,000	$7,000	$7,000	--
1983	12,000	12,000	12,000	--
1984	12,000	12,000	12,000	$2,000
1985	12,000	11,000	12,000	12,000
1986	12,000	13,000	12,000	12,000
1987	12,000	12,000	12,000	12,000
1988	12,000	12,000	12,000	12,000

During 1989, KWJ Co. paid the Lisle and the Ballard children $36,000. Of the $36,000 paid to the children in 1989, Lisle's children received at least $18,000 and Ballard's children received at least $12,000.

Petitioners claim that Thomas Lisle and Melinda Ballard were paid the consulting fees for various services they provided to KWJ Corp. or KWJ Co. (KWJ). During the timeframe that Thomas Lisle was receiving $1,000 a month, he was employed elsewhere full time. During part of this time, Thomas Lisle was employed with the Vantage Company (Eulich's company).

Melinda Ballard received $1,000 a month from KWJ from 1983 through parts of 1989. She did not know the nature of KWJ's business. Neither Thomas Lisle nor Melinda Ballard ever met or spoke to Freeman.

Karen Ballard Hart (Hart) also received $1,000 a month. During the time that Hart was receiving $1,000 a month from KWJ, she was employed elsewhere.

Hart testified that the "service" she performed was to attend

Urban Land Institute and Hotel Industry meetings. After she attended these meetings, she would sometimes tell Kanter what she had heard at the meetings, and sometimes she would not tell him what she had heard. Half of the time, Kanter was at the same meetings she attended. Hart described her role as "more of a general hotel industry trend thing" that she would tell Kanter about whenever she was asked. She did not know that she supposedly worked for KWJ. The $1,000 a month that Hart received was paid to her by checks from Administration Co., and she testified that she worked for Administration Co.

Amy Albrecht (Albrecht) described her role as looking at "deals". Albrecht's testimony that she submitted on the average anywhere from 20 to 40 deals a year to Freeman greatly exceeds the 5 or 6 deals a year she had previously claimed during an interview with IRS agents. The $1,000 a month that Albrecht received did not depend on what she did or how many "deals" she looked at. She received $1,000 a month even if she did nothing. The checks issued to Albrecht were from either KWJ or Administration Co. During the time that Albrecht was receiving $1,000 a month from KWJ or Administration Co., she was employed by the Vantage company.

The testimony of Thomas Lisle, Melinda Ballard, Hart, and Albrecht is not credible. They performed no services for KWJ. The payments to them were from funds Ballard and Lisle earned from the Prudential transactions.

The record clearly shows that Kanter, Ballard, and Lisle agreed to share the payments made by the Five related to the Prudential transactions that were paid to IRA, Zeus, and KWJ Corp. in the ratio of 45 percent each to Ballard and Lisle and 10 percent to Kanter. Most of the funds were accumulated in IRA or a subsidiary until after Ballard and Lisle left Prudential. It was then that 45 percent of the accumulated funds were distributed to each of Lisle and Ballard, respectively, through Carlco and TMT, and 10 percent to Kanter through BWK, Inc.

Respondent has established by clear and convincing evidence that Ballard failed to report income from the Five in the following amounts for each of the years at issue:

Year	Omitted Income
1978	$17,277
1979	186,758
1980	391,538
1981	467,972
1982	710,001
1984	337,715
1987	300,900
1988	283,440
1989	358,492

Respondent has established by clear and convincing evidence that Lisle failed to report income from the Five in the following amounts for each of the years at issue:

Year	Omitted Income
1984	337,715
1987	300,900
1988	283,440
1989	358,492

Respondent has established by clear and convincing evidence that Kanter omitted income from the Five in the following amounts for each year at issue:

Year	Prudential	Other	Omitted Income
1978	$3,839	--	$3,839
1979	41,502	--	41,502
1980	87,009	--	87,009
1981	103,994	$80,616	184,610

1982	157,778	70,538	228,316
1983	72,181	294,075	366,256
1984	75,048	822,840	897,888
1986	63,353	1,069,335	1,132,688
1987	66,867	132,322	199,189
1988	62,987	96,188	159,175
1989	79,665	42,332	121,997

For each of the years 1979 through 1989, Kanter filed Federal income tax returns which reported adjusted gross income and income tax paid as follows:

Year	Adjusted Gross Income (Loss)	Tax Paid
1978	($44,386)	$1,671
1979	(105,084)	--
1980	(155,026)	--
1981	(53,614)	--
1982	(287,536)	--
1983	(819,449)	--
1984	(804,482)	--
1985	(954,695)	--
1986	(1,529,213)	--
1987	(2,004,257)	--
1988	(1,340,459)	--
1989	(1,331,576)	--

Kanter paid no Federal income taxes during an 11-year period, and only minimum tax in 1978 of $1,671. However, he did pay self-employment tax for the years 1978 ($1,434), 1979 ($1,855), 1980 ($2,098), and 1983 ($3,338).
Because respondent has shown by clear and convincing evidence that Kanter, Ballard, and Lisle omitted income on their Federal income tax returns for each of the years at issue, respondent has clearly proven the underpayments of income tax attributable to such omitted income for those

years.

E. Intent to Evade Tax

Next, respondent must show by clear and convincing evidence that Ballard, Lisle, and Kanter intended to evade taxes known to be owing by conduct intended to conceal, mislead, or otherwise prevent the collection of such taxes. See Stoltzfus v. United States, 398 F.2d 1002, 1004 (3d Cir.1968).

The existence of fraud is a question of fact to be resolved upon consideration of the entire record. See Gajewski v. Commissioner, 67 T.C. 181, 199, 1976 WL 3591 (1976), affd. without published opinion 578 F.2d 1383 (8th Cir.1978). Fraud is not presumed or imputed; it must be established by independent evidence that establishes a fraudulent intent on the taxpayer's part. See Otsuki v. Commissioner, 53 T.C. 96, 106, 1969 WL 1605 (1969). Because direct proof of a taxpayer's intent is rarely available, fraud may be proved by circumstantial evidence, and reasonable inferences may be drawn from the relevant facts. See Spies v. United States, 317 U.S. 492, 499, 63 S.Ct. 364, 87 L.Ed. 418 (1943); Stephenson v. Commissioner, 79 T.C. 995, 1006, 1982 WL 11202 (1982), affd. 748 F.2d 331 (6th Cir.1984). For example, an intent to conceal or mislead may be inferred from a pattern of conduct, see Spies v. United States, supra at 499, or from a taxpayer's entire course of conduct, see Stone v. Commissioner, 56 T.C. 213, 223-224, 1971 WL 2605 (1971). Likewise, a pattern showing a consistent underreporting of income, when accompanied by circumstances evidencing an intent to conceal, may justify a strong inference of fraud. See Parks v. Commissioner, 94 T.C. 654, 664, 1990 WL 48997, (1990). Additions to tax for fraud have been upheld where taxpayers received income from illegal kickback schemes. See Tregre v. Commissioner, T.C. Memo.1996-243, affd. without published opinion 129 F.3d 609 (5th Cir.1997); DeVaughn v. Commissioner, T.C. Memo.1983-712; Hanhauser v. Commissioner, T.C.1978-504. These cases bear some factual similarities to the instant cases.

Factors Indicative of Fraudulent Intent

Courts have relied on a number of indicia of fraud in deciding fraud cases. The existence of several indicia is persuasive circumstantial evidence of fraud. See Solomon v. Commissioner, 732 F.2d 1459, 1461 (6th Cir.1984), affg. per curiam T.C. Memo.1982-603. A non-exclusive list of circumstantial evidence which gives rise to a finding of fraudulent intent includes: (1) a pattern of understating income over an extended period of time; see Foster v. Commissioner, 391 F.2d 727, 733 (4th Cir.1968), affg. in part, revg. in part T.C. Memo.1965-246); (2) implausible or inconsistent explanations of behavior; see Bahoric v. Commissioner, 363 F.2d 151, 153 (9th Cir.1966); Factor v. Commissioner, 281 F.2d 100 (9th Cir.1960), affg. T.C. Memo.1958-94; (3) failure to cooperate with tax authorities; see McCullough v. Commissioner, T.C. Memo.1993-70; (4) failure to produce records during discovery, see Scallen v. Commissioner, 877 F.2d 1364, 1370 (8th Cir.1989), affg. T.C. Memo.1987-412; (5) destruction of records, see Estate of Beck v. Commissioner, 56 T.C. 297, 1971 WL 2514 (1971); (6) misleading statements or actions, see McManus v. Commissioner, T.C. Memo.1972-200, affd. without published opinion 486 F.2d 1399 (4th Cir.1973), (7) commingling of personal assets with those of the taxpayer's corporation in an attempt to avoid tax, see United States v. Walton, 909 F.2d 915 (6th Cir.1990); (8) diversion of income to third parties, see Lewis v. Commissioner, T.C. Memo.1983-547; (9) reporting income from property beneficially owned by the taxpayer on the returns of family members, see Lang v. Commissioner, T.C. Memo.1961-134; (10) structuring of a business and use of cash management techniques which made difficult the tracing of income, see Scallen v. Commissioner, supra at 1370- 1371; (11) banking devices used to conceal earnings, see Maddas v. Commissioner, 114 F.2d 548 (3d Cir.1940), affg. 40 B.T.A. 572 (1939); (12) concealing income under the names of other persons who reported such income, see Hecht v. Commissioner, 16 T.C. 981, 1951 WL 146 (1951); and (13) omission of income from

the taxpayer's property, title to which was held in names of others who reported the income therefrom, see Furnish v. Commissioner, 262 F.2d 727 (9th Cir.1958). In addition, the taxpayer's educational background and experience are relevant. See Scallen v. Commissioner, supra at 1371; United States v. Stein, 437 F.2d 775 (7th Cir.1971).

1. Lisle's Fraud

Respondent has proven by clear and convincing evidence that Lisle underpaid his taxes for each of the years at issue attributable to omitted income from transactions related to the Five.

Respondent has also proven by clear and convincing evidence that Lisle intended to evade taxes known to be owing on that income by conduct designed to conceal, mislead, or otherwise prevent the collection of such taxes. The record contains several indicia of Lisle's fraud with intent to evade tax.

In determining the presence or absence of fraud, we consider the training and experience of the taxpayer. See Iley v. Commissioner, 19 T.C. 631, 635, 1952 WL 110 (1952). Lisle graduated from the University of Missouri with a B.S. degree in public administration. He attended law school at the University of Missouri, graduate schools of management and business at Columbia University, and the graduate school of management at Princeton University. Lisle was an experienced and sophisticated businessman who held high executive positions at Prudential and later at Travelers. As such, he obviously understood and fully appreciated his obligation to report income correctly and to pay taxes on that income. Nevertheless, he disregarded this obligation by participating in various schemes to collect kickbacks from the Five and misdirect income through Kanter's maze of entities.

Consistent and substantial understatements of income are strong evidence of fraud. See Marcus v. Commissioner, 70 T.C. 562, 577, 1978 WL 3338 (1978), affd. without published

opinion 621 F.2d 439 (5th Cir.1980). Moreover, a pattern of consistent underreporting of income, when accompanied by other circumstances indicating an intent to conceal income justifies the inference of fraud. See Holland v. United States, 348 U.S. 121, 137, 75 S.Ct. 127, 99 L.Ed. 150 (1954). Lisle omitted income received from transactions with the Five during the years 1984 and 1987 through 1989 in the total amount of $1,280,547. Additionally, for the years 1978 through 1983, 1984, and 1985, years not before us here, he omitted $2,734,707.

Lisle allowed Kanter to commingle his share of the kickback moneys in the laundering mechanism Kanter created to conceal the true nature of the income and the identity of the earner of the income. Lisle's use of the various Kanter sham entities (including among others, IRA, Carlco, KWJ Corp., KWJ Co., Essex, Zeus, Holding Co., Int'l Films, HELO, Administration Co., and Principal Services) made it difficult and sometimes impossible to trace the cash-flow and is substantial evidence of Lisle's intent to evade tax. See Scallen v. Commissioner, supra at 1371. Commingling by laundering is an indication of fraudulent intent. See United States v. Jackson, 983 F.2d 757 (7th Cir.1993). Commingling of the kickbacks in the accounts of the conduit entities, together with other unrelated income, was a device to hide the kickbacks from Prudential and the IRS, and is evidence of fraud. See Maddas v. Commissioner, 114 F.2d 548 (3d Cir.1940).

There is fraud where there is a scheme to "thwart the effective functioning of the IRS" and where there is an attempt to disguise the source of income. See United States v. Browning, 723 F.2d 1544, 1547 (11th Cir.1984). Lisle plainly attempted to disguise the source of the kickback funds by the manner employed in sending the moneys through a roundabout method over a period of many years through Kanter's conduit entities. To be sure, the movement of the moneys had no legitimate business purpose, as demonstrated by the evidence.

The use of nominees, placing money or property in the name

of another, is indicative of fraud. See United States v. Peterson, 338 F.2d 595 (7th Cir.1964); Furnish v. Commissioner, supra, where the Court of Appeals stated that "Concealment by itself is indicative of a willful intent to evade income taxes." Lisle used IRA and later Carlco as a nominee to receive and hold and conceal the kickback payments he received for his services.

Failure to cooperate with revenue agents during an audit examination is indicative of fraud. See Bradford v. Commissioner, 796 F.2d 303 (9th Cir.1986), affg. T.C. Memo.1984-601. As reflected in our findings of fact, Lisle did not cooperate with respondent's agents at various stages of their investigation of his tax returns. He withheld relevant documents and information involving transactions with the Five.

Destruction of records and attempts to place records beyond the reach of the revenue agents are evidence of fraud. See Prokop v. Commissioner, 254 F.2d 544 (7th Cir.1958), affg. T.C. Memo.1957-75; Estate of Beck v. Commissioner, 56 T.C. 297, 1971 WL 2514 (1971). We find that Lisle discarded and permitted others, including Kanter, Gallenberger, and Weisgal, to discard supporting income documentation, which was an intentional act designed to conceal and evade the reporting and payment of Federal income tax.

Misleading statements or actions are evidence of fraud. See McManus v. Commissioner, T.C. Memo.1972-200, affd. without published opinion 486 F.2d 1399 (4th Cir.1973). Lisle made the following misleading statements to the IRS agents who interviewed him during their examination of Kanter's returns:

(1) Lisle told the agents that Schaffel had transacted business with Prudential prior to Kanter's introduction of Schaffel to Lisle;

(2) he told the agents that he was not aware of the dispute between Kanter and Schaffel regarding kickbacks for Travelers' deals;

(3) he told the agents that he was not aware of any

agreement between Schaffel and Kanter to share commissions Schaffel earned from the introduction to Ballard and Lisle.

(4) he told the agents that Kanter mainly dealt with the field offices when introducing people to Prudential for business;

(5) he denied any knowledge of the Christie Trust established for the benefit of his children;

(6) he denied any knowledge of the Christie Trust's ownership of Carlco stock; and

(7) he claimed that he had only recently learned about loans made by the Kanter entities to his family trusts and denied that any loans had been made to him.

Lisle's pattern of consistent and substantial underreporting of income, along with other indicia indicating an intent to conceal income, justifies our finding that Lisle's underpayment of tax attributable to the income he omitted from transactions involving the Five is attributable to fraud.

2. Ballard's Fraud

Respondent has proven by clear and convincing evidence that Ballard underpaid his taxes for each of the years at issue attributable to omitted income from transactions related to the Five. Respondent has also proven by clear and convincing evidence that Ballard intended to evade taxes known to be owing on that income by conduct designed to conceal, mislead, or otherwise prevent the collection of such taxes. There are several indicia of Ballard's fraud with intent to evade tax.

Although Ballard's educational background is not in the record, he was a sophisticated and experienced businessman who held high executive positions at Prudential, and later at Goldman Sachs. As such, he obviously understood and fully appreciated his obligation to report income correctly and to pay taxes on that income. Nevertheless, he disregarded this obligation by participating in various schemes to collect kickbacks from the Five and misdirect income through Kanter's maze of entities.

As our findings show, Ballard omitted income received from transactions with the Five during the years 1978 through 1982, 1984, and 1987 through 1989 in the total amount of $3,054,093. Additionally, for the years 1983, 1985, and 1986, years not before us here, he omitted $961,161.

Ballard used IRA and later TMT as a nominee to receive and hold the kickback payments he received for his services.

Ballard did not cooperate with respondent's agents at various stages of their investigation of his tax returns. He withheld relevant documents and information involving transactions with the Five.

Ballard discarded and permitted others, including Kanter, Gallenberger, and Weisgal, to discard supporting income documentation, an intentional act designed to conceal and evade the reporting and payment of Federal income tax.

Ballard allowed Kanter to commingle his share of the kickback moneys in the laundering mechanism Kanter used to conceal its identity. Ballard's use of the various Kanter sham entities (including among others, IRA, TMT, KWJ Corp., KWJ Co., Essex, Zeus, Holding Co., Int'l Films, HELO, Administration Co., and Principal Services) made it difficult and sometimes impossible to trace the cash-flow and is substantial evidence of Ballard's intent to evade tax.

Commingling the kickbacks in the accounts of the conduit entities, together with other unrelated income, was a device to hide the kickbacks from Prudential and the IRS, and is evidence of Ballard's fraud.

Ballard plainly attempted to disguise the source of the kickback funds by funneling money in the roundabout method through the conduit entities over a period of many years.

Ballard made the following misleading and false statements:

(1) He testified that at the dinner meeting where Kanter introduced Schaffel to Ballard and Lisle, they only discussed politics, football, and religion, and that no business was discussed;

(2) he testified that he did not know whether Walters had transacted any business with Prudential when Ballard was at

Prudential and that he was not involved with the Ramada Renaissance property; yet he met with Schaffel and Walters to finalize the financing of the Cherry Creek Place II and the Ramada Renaissance properties;

(3) he testified that Prudential did not purchase the Schnitzer-PMS stock because, apart from the potential conflict of interest, Prudential did not have any business to give to Schnitzer-PMS; yet Prudential started giving Schnitzer- PMS substantial business;

(4) he testified that he had no involvement and no meetings with Connolly other than seeing him at the Gateway hotel; yet he is the person who introduced Connolly to Eulich for purposes of setting up the Essex arrangement.

Finally, we find Ballard's testimony vague, evasive, and unreliable as to the kickback payments in the face of overwhelming evidence to the contrary.

Ballard's pattern of consistent and substantial underreporting of income, when accompanied by the other indicia indicating an intent to conceal income, justifies our finding that Ballard's underpayment of tax attributable to income he omitted from transactions involving the Five is attributable to fraud.

3. Kanter's Fraud

Kanter was the architect who planned and executed the elaborate scheme with respect to the kickback income payments received from the transactions involving the Five. Ballard and Lisle participated with him, shared in the payments, and cooperated in the diversions. In our view, what we have here, purely and simply, is a concerted effort by an experienced tax lawyer and two corporate executives to defeat and evade the payment of taxes and to cover up their illegal acts so that the corporations, Prudential and Travelers, and the Federal Government would be unable to discover them.

Respondent has proven by clear and convincing evidence that Kanter underpaid his taxes for each of the years at issue attributable to transactions related to the Five. Respondent

has also proven by clear and convincing evidence that Kanter intended to evade taxes known to be owing on that income by conduct designed to conceal, mislead, or otherwise prevent the collection of such taxes.

The record is replete with several indicia of Kanter's fraud. They are:

First, Kanter has a legal education. He has been a practicing tax attorney since 1956. He has taught courses in estate and gift taxation and estate planning at the University of Chicago Law School. He has lectured and written extensively in the area of Federal tax law. For a number of years, he has been a writer and contributor to the Journal of Taxation, a national monthly publication devoted exclusively to Federal taxation. Kanter, as an experienced tax attorney, obviously understood and fully appreciated his legal obligations to report income correctly and to pay taxes on that income. Nevertheless, he disregarded these obligations by conceiving and carrying out various schemes to misdirect income. Furthermore, he was or should have been aware that his Federal income tax liabilities were substantially underreported for each of the years in issue.

Second, as we have previously found, Kanter reported adjusted gross losses on his Federal income tax returns for every year from 1978 through 1989. For 11 of those years he paid no Federal income taxes, and only minimum tax of $1,671 in 1978. Kanter omitted income received from transactions with the Five during the years 1978 through 1989 (except for 1985) in the total amount of $3,422,469. Even for 1985, a year not before us here, he omitted $1,592,939.

Third, Kanter created a complex laundering mechanism made up of sham corporations and entities (including among others, IRA, Carlco, TMT, BWK, Inc., KWJ Corp., KWJ Co., Essex, Zeus, Holding Co., Int'l Films, HELO, Administration Co., and Principal Services) to receive, distribute, and conceal his income, as well as Ballard's and Lisle's income. Payments made for their services were paid to IRA and Holding Co. or one of their subsidiaries. The

payments were commingled with funds from other entities in Administration Co.'s accounts and later Principal Service's accounts. Large amounts of money were distributed to various entities and individuals, including Kanter, Ballard, and Lisle, through IRA, Holding Co., HELO, Int'l Films, and the Bea Ritch trusts. The distributions were disguised as loans and recorded as receivables. The receivables were shuffled (through book entries) between the various entities and eventually written off. Kanter's use of the various sham entities made it difficult and sometimes impossible to trace the flow of the money and is substantial evidence of his intent to evade tax. See Scallen v. Commissioner, 877 F.2d 1364, 1370-1271 (8th Cir.1989).

Fourth, as reflected in our findings of fact, Kanter did not cooperate with respondent's agents at various stages of their investigation of his tax returns. He withheld relevant documents and information involving transactions with the Five and the movement of moneys through the conduit entities such as Administration Co., IRA, Holding Co., and others.

Kanter caused some records to be destroyed and attempted to place other records beyond the reach of the revenue agents conducting the investigation. We find in particular that destruction of records that were the subject of the IRS summonses after the issuance of the summonses to be a strong indication of fraud. "The summons had no time limit, was never withdrawn, and * * * required the recipient to retain--indefinitely--the documents within its scope." United States v. Administrative Enters., Inc., 46 F.3d at 673.

Gallenberger and Weisgal claim that records had been discarded pursuant to a 3-year retention policy based on the normal 3-year statute of limitations for assessing tax deficiencies. Yet the records they destroyed related to returns that were being audited and were the subject of IRS administrative summonses. We think that such a 3-year retention policy could not justify the destruction of corporate minutes, stock ownership records, or resolutions by the

boards of directors. Moreover, some of the entities involved were trusts or corporations owned by trusts. Corporate officers and directors, as well as trustees of trusts, are often required to account to shareholders and beneficiaries for periods greater than 3 years. None of the individuals involved with the various entities (Gallenberger, Weisgal, Meyers, and Schott) acted in any independent manner. They all acted as directed by Kanter. It is clear that they destroyed the records at Kanter's direction.

Kanter, a tax professional who represents clients before the IRS and this Court, is aware of the need for documentation and records to support the items reported on tax returns. In light of that knowledge, coupled with other evidence, we find that his discarding of his supporting income documentation was an intentional act designed to conceal and evade the reporting and payment of Federal income tax.

Fifth, Kanter's commingling of his income with the moneys of others is an indication of fraud in an attempt to avoid tax. United States v. Walton, 909 F.2d 915 (6th Cir.1990). The use of IRA and the other entities by Kanter and the commingling of the kickback moneys were part of the laundering mechanism designed by Kanter. All of the commingling of Kanter's income, as well as that of Ballard and Lisle, was done at his direction. Commingling of the kickbacks in Administration Co.'s accounts, together with other unrelated income, was designed to conceal the kickbacks. The commingling and laundering are evidence of fraud. Maddas v. Commissioner, 114 F.2d 548 (3d Cir.1940); United States v. Jackson, supra.

Sixth, Kanter's scheme was intended to "thwart the effective functioning of the IRS" and was an attempt to disguise the source of income. Kanter plainly attempted to disguise the source of the kickback funds by the manner employed in sending the moneys through conduit entities in a roundabout method over a period of many years. Obviously, he, as well as Ballard and Lisle, did not want Prudential and Travelers to know about the kickback payments. Certainly, the movement of the moneys had no legitimate business

purpose.

Seventh, Kanter's reporting of the kickback moneys on the returns of IRA and Holding Co. was designed to conceal the scheme, and is another strong indication of Kanter's fraud. See Lang v. Commissioner, T.C. Memo.1961-134, where the reporting of income from property beneficially owned by the taxpayer on the returns of family members was held to be fraudulent. It is clear that Kanter used the sham corporations to give the appearance that the kickback income was earned by them, rather than Ballard, Lisle, and himself, and that there was no tax due by the corporations because there were claimed losses sufficient to offset the income. Moneys were distributed from IRA and Holding Co. at Kanter's direction to other entities that were created to conceal further the true nature of the payments. Three of those entities, TMT, Carlco, and BWK Inc., were controlled respectively by Ballard, Lisle, and Kanter, and were the repositories of the kickback moneys distributed from IRA.

Eighth, Kanter routinely used the various conduit entities as nominees, placing money and property in the names of the entities to conceal the transactions. In fact, when it was convenient, he would assert that the entity held an asset merely as nominee.

Ninth, Kanter created phony loans to disguise the distributions of the income to himself and others and to evade the income tax due on the income. He later arranged for sales of the receivables for nominal amounts in order to claim false bad debt deduction losses and offset additional income reported on his returns and the returns of the conduit entities.

Tenth, as discussed previously, Kanter's testimony at trial was implausible, unreliable, and sometimes contradictory. We did not find it credible.

Finally, other factors that support a finding of Kanter's fraud include, but are not limited to, manipulations of deductions and income between various corporate, partnership, and trust entities to conceal not only his income but the income

the use of the various artifices to divert the payments to his children and trusts benefiting his family.

Kanter's substantial understatements of income over an 11-year period, his intentional misdirection of income, and his deliberate mischaracterizations of the transactions are clear and convincing evidence of his fraudulent intent to evade taxes, particularly in light of his legal education and experience and overall tax sophistication. See Scallen v. Commissioner, 877 F.2d 1364, 1370-1371 (8th Cir.1989); Sisson v. Commissioner, T.C. Memo.1994-545, affd. without published opinion 108 F.3d 339 (9th Cir.1996); Wheadon v. Commissioner, T.C. Memo.1992-633.

The transactions involved here were masquerades, concealing the true character of the payments. In reality, an attorney and two highly successful businessmen conspired to conceal millions of dollars of kickbacks, using a multitude of entities with friends and employees serving as officers of

Ballard and Lisle and evade taxes properly owed to the Government.

As each layer of Kanter's complex organization is removed, and the flow of the money is followed, the magnitude of the fraud is revealed. Kanter's explanations are mere platitudes and rationalized rhetoric intended to obfuscate the true character of the transactions and his wrongdoing.

f. Summary and Conclusions as to Fraud

The addition to tax or penalty in the case of fraud is a civil sanction provided primarily as a safeguard for the protection of the revenue and to reimburse the Government for the heavy expense of investigation and the loss resulting from the taxpayer's fraud. Helvering v. Mitchell, 303 U.S. 391, 401, 58 S.Ct. 630, 82 L.Ed. 917 (1938). The facts, as we have found in detail, clearly show that Kanter, Ballard, and Lisle, through the use of various conduit entities, devised a multifaceted scheme to shield kickback payments they received from transactions involving the Five. Their fraud

resulted in the Federal Government not being paid several millions in income taxes due and owing. Clearly, the Government incurred great expense investigating petitioners' returns. The investigation took years and involved the efforts of dozens of IRS agents and several Government attorneys.

Petitioners created profitable business deals between the Five and Prudential and Travelers. The large sums of money they received as kickbacks were diverted at Kanter's direction to their controlled conduit entities. To effectuate the part of the scheme involving the Prudential transactions, Kanter through his related entities (IRA and its subsidiaries), retained the moneys for a period of time until they were distributed directly or indirectly to Ballard, Lisle, and himself in a 45-45-10 percent split. To effectuate the remaining part of the scheme involving the payments for Kanter's services, including payments from the Schaffel/Travelers transactions, Kanter caused the moneys to be paid to Holding Co., which he controlled.

As a result of the overall scheme, over $13 million of kickback and other income was omitted by petitioners collectively. The evidence is clear and convincing that they intended to evade the payment of their taxes on such omitted income. Accordingly, after considering all the facts and circumstances contained in the massive record of these cases, we hold that Kanter, Ballard, and Lisle are liable for the fraud additions to tax and penalties for each of the years at issue.

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Footnotes

FN1. Cases of the following petitioners are consolidated herewith: Burton W. and Naomi R. Kanter, docket No. 712-86; Investment Research Associates, Ltd., and Subsidiaries, docket No. 45273-86; Burton W. and Naomi R. Kanter, docket No. 1350-87; Burton W. and Naomi R. Kanter, docket No. 31301-87; Burton W. and Naomi R. Kanter, docket No. 33557- 87; Burton W. and Naomi R. Kanter, docket No. 3456-88; Investment Research Associates, Ltd., and Subsidiaries, docket No. 30830-88; Burton W. and Naomi R. Kanter, docket No. 32103-88; Investment Research Associates, Ltd., and Subsidiaries, docket No. 27444-89; ←Claude→ M. and Mary B. ←Ballard,→ docket No. 16421-90; Investment Research Associates, Ltd., and Subsidiaries, docket No. 25875-90; Burton W. and Naomi R. Kanter, docket No. 26251-90; ←Claude→ M. and Mary B. ←Ballard,→ docket No. 20211-91; Estate of Robert W. Lisle, Deceased, Thomas W. Lisle and Amy L. Albrecht, Independent Co-executors, and Estate of Donna M. Lisle, Deceased, Thomas W. Lisle and Amy L. Albrecht, Independent Co-executors, docket No. 20219-91; Estate of Robert W. Lisle, Deceased, Thomas W. Lisle and Amy L. Albrecht, Independent Co-executors, and Estate of Donna M. Lisle, Deceased, Thomas W. Lisle and Amy L. Albrecht, Independent Co- executors, docket No. 21555-91; ←Claude→ M. and Mary B. ←Ballard,→ docket No. 21616-91; Investment Research Associates, Ltd., and Subsidiaries, docket No. 23178-91; Burton W. and Naomi R. Kanter, docket No. 24002-91; ←Claude→ M. and Mary B. ←Ballard,→ docket No. 1984-92; Estate of Robert W. Lisle, Deceased, Thomas W. Lisle and Amy L. Albrecht, Independent Co- executors, and Estate of Donna M. Lisle, Deceased, Thomas W. Lisle and Amy L. Albrecht, Independent Co-executors, docket No. 16164-92; Investment Research Associates, Ltd., and Subsidiaries, docket No. 19314-92; ←Claude→ M. and Mary B. ←Ballard,→ docket No. 23743-92; Burton W. and Naomi R. Kanter, docket No. 26918-92; Estate of Robert W. Lisle, Deceased, Thomas W.

Lisle and Amy L. Albrecht, Independent Co-executors, and Estate of Donna M. Lisle, Deceased, Thomas W. Lisle and Amy L. Albrecht, Independent Co- executors, docket No. 7557-93; ←Claude→ M. and Mary B. ←Ballard,→ docket No. 22884-93; Investment Research Associates, Ltd., and Subsidiaries, docket No. 25976-93; and Burton W. and Naomi R. Kanter, docket No. 25981-93.

FN2. Unless otherwise indicated, section references are to the Internal Revenue Code in effect for the years at issue. All Rule references are to the Tax Court Rules of Practice and Procedure.

FN3. With respect to the additions to tax under sec. 6653, as to all of the cases before the Court, for the years 1979 and 1980, the addition to tax is under sec. 6653(a). For the years 1981 through 1985, the addition to tax is under sec. 6653(a)(1). For the years 1981 through 1985, respondent also determined the addition to tax under sec. 6653(a)(2), which is 50 percent of the interest due on the underpayment of tax attributable to negligence or intentional disregard of rules or regulations. For the years 1986 and 1987, the addition to tax is under sec. 6653(a)(1)(A), and the determined 50-percent interest due on the underpayment is under sec. 6653(a)(1)(B). For 1988, the addition to tax is under sec. 6653(a)(1), and there is no corresponding addition to tax for 50 percent of the interest due on the underpayment. See Technical and Miscellaneous Revenue Act of 1988, Pub.L. 100-647, sec. 1015(b)(2)(A), 102 Stat. 3342, 3568, applicable to returns the due date for which, without regard to extensions, is after Dec. 31, 1988.

FN4. Sec. 6621(d)(1) was added by the Deficit Reduction Act of 1984, Pub.L. 98-369, sec. 144(a), 98 Stat. 682, and provides for interest of 120 percent of the adjusted interest rate due on any substantial underpayment of tax attributable to tax-motivated transactions. The increased interest is effective for interest accruing after Dec. 31, 1984. Sec. 6621(d) was

redesignated as sec. 6621(c) by sec. 1511(c)(1)(A) of the Tax Reform Act of 1986, Pub.L. 99-514, 100 Stat.2085, 2744, and repealed by sec. 7721(b) of the Omnibus Budget Reconciliation Act of 1989 (OBRA 89), Pub.L. 101-239, 103 Stat. 2106, 2399, effective for tax returns due after Dec. 31, 1989, OBRA 89 sec. 7721(d), 103 Stat. 2400.

FN5. For the years 1976 through 1981, the addition to tax for fraud is under sec. 6653(b). For the years 1982 through 1985, the addition to tax for fraud is under sec. 6653(b)(1) and (2). For 1986 and 1987, the addition to tax for fraud is under sec. 6653(b)(1)(A) and (B). For 1988, the addition for fraud is under sec. 6653(b)(1). For 1989, the penalty for fraud is under sec. 6663(a).

FN6. In some of the cases, if petitioners are sustained on the fraud issue, respondent will be barred by the statute of limitations from assessment as to those petitioners.

FN7. Prudential conducted its real estate equity and joint venture operations in the name of PIC Realty in those States that prohibited insurance corporations from directly engaging in real estate development.

FN8. The Everglades Trusts 1-5, shareholders in Holding Co., were grantor trusts in which Kanter was the deemed owner under secs. 671 through 678.

FN9. Administration Co. was organized at the insistence of some of the members of Kanter's law firm who complained that law firm employees working under Kanter were performing extensive nonlegal services for which the law firm was not being compensated.

FN10. Gallenberger was an accountant. Shortly after arriving in Chicago, Illinois, she passed the certified public accountant's examination. Gallenberger became an employee of Administration Co. in 1982.

FN11. The record does not contain the information for 1982.

FN12. Prior to 1979, Schaffel had rented office space from Torcivia.

FN13. The $1.3 million purchase price was roughly based on a multiple of five times net earnings. At the time, the company had before-tax net income of $250,000.

FN14. After Lisle began working for Travelers in 1982, he dealt with Eulich in connection with the managing of Travelers' properties.

FN15. Although Hilton Hotels had been reluctant to grant Prudential a franchise, Ostroff obtained the franchise by pointing out to Hilton Hotels the other profitable business dealings it had with Prudential.

FN16. Prudential did not want to have its employees involved in operating the hotel and did not want any of the hotel's employees to be Prudential employees.

FN17. The letter stated:
Per our telephone conversation today, I am enclosing the following material: 1. Your 20 shares of stock in Gateway Hotel Management Company representing 20% of the company.
2. A xerox copy of 80 shares of stock owned by Essex Hotel Management Company representing 80% of the company.
3. A copy of the minutes of the first meeting of the Board of Gateway--the original is being circulated for signature and will be sent for signature soon.
4. A xerox copy of your option on the Essex Hotel Management Company stock--the original is being circulated for signature currently.
As we discussed on the phone, we will be sending you a check for $10,000.00 which represents the capitalization of Gateway that should be used as the corporation's initial bank

deposit. When the first profit distribution is made we would appreciate your sending us a check for $2,000 representing 20% of this capital.
If you have any questions about this transaction, please let me know. We are looking forward to working with you in what is hopefully a mutually pleasant and profitable venture.

FN18. On Dec. 21, 1984, Essex Corp. assigned its option to purchase the 80 shares of Gateway Corp. to the Essex partnership.

FN19. Although Ostroff and Prudential ultimately awarded the Midland, Texas, hotel's management contract to Gateway Corp., Gateway Corp. and Eulich-Management had each submitted bids on the Midland hotel's management contract. During this time, Prudential usually obtained bids from at least three hotel management companies for a particular hotel's management contract.

FN20. The Eulich-Management agreement indicates that, although it was effective as of Jan. 1, 1982, it was executed as of July 5, 1982.

FN21. The consulting and participation agreement for the Twin Sixties hotel was entered into to replace the income that Essex would lose following the expected termination of Eulich-Management's management contract for the Allentown Hilton, as the Allentown Hilton was then in the process of being sold.

FN22. Essex reported its income on the cash method until 1987. For the 1987 taxable year and thereafter Essex reported on the accrual method.

FN23. During the years at issue the consolidated net losses did not equal the total of the net losses of the consolidated group because of special deductions.

FN24. IRA's 1978 return reported $1,442,930 total assets as of the close of the year, $34,024 of which was the amount of its investment in subsidiaries. The 1979 return reported $1,592,930 of total assets as of the beginning of the year, $184,024 of which was the amount of its investment in subsidiaries. The $150,000 difference is the amount IRA agreed to pay for the KWJ Corp. stock.

FN25. On IRA's 1988 consolidated return, IRA reported that it contributed $60,000 to Decisions Holding Corp. in the sec. 351 transaction in exchange for 85 percent of the stock of Decisions Holding Corp. The return, however, also reported the transfers of IRA's stock in Cedilla Invest. and Zeus to Decisions Holding Corp. See infra Issue 23.

FN26. On December 5, 1983, Zeus transferred $13,000 to IRA in exchange for a $13,000 receivable from Holding Co. IRA's general ledger shows that in 1983 Holding Co.'s subsidiary Zion acquired from IRA a $15,000 receivable due from Holding Co. for $15,000. The 1984 general ledger shows that Zeus' loans receivable of $866,000 included $802,000 owed by Holding Co. and $64,000 owed by HELO. The record does not disclose how Zeus acquired the remaining receivable of $15,000 from Holding Co.

FN27. Based on IRA's consolidated returns, Zeus contributed to unidentified partnerships $100,000 in 1979 and $127,372 in 1980 and received a return of capital of $63,696 in 1981 and $1 in 1982 (probably due to rounding of numbers) computed as follows:

1979 Initial contribution $100,000
Plus 1980 nontaxable income 6,828

Total adjustments and contributions 106,828

Plus 1980 contributions

value end 1980 234,200
less prior adjustments and contributions (106,828)

1980 contributions 127,372 127,372

Value end 1980 234,200

Value end 1980 234,200
plus 1980 taxable income 2,382
---
total adjustments and contributions 236,582

Less return of capital
value end 1981 172,896
less prior adjustments and contributions (236,582)

1981 return of capital (63,686) (63,686)

Value end 1981 172,896

Value end 1981 172,896
Less 1982 taxable loss (150,907)
Less 1982 nontaxable loss (27,061)
---
total adjustment and contributions (5,072)

Less return of capital
value end 1982 (5,073)
less prior adjustments and contributions 5,072

1982 return of capital (1) (1)

Value end 1982 (5,073)

Value end 1982 (5,073)
Less 1983 taxable loss (15,049)
Less 1983 nontaxable loss (753)

Value end 1983 (20,875)

FN28. Schaffel also paid $312,750 to IRA in 1983 for fees related to Traveler's transactions.

FN29. The difference between total of $44,412 and $44,413 is due to rounding of numbers.

FN30. Thomas Lisle and Amy Albrecht admitted that they received consulting fees from 1983 to 1989. Melinda Ballard admitted that she received the consulting fees from 1983 to 1988. Karen Hart admitted that she received the consulting fees from 1984 to 1989. No one except the Lisle and Ballard children received consulting fees from 1983 through 1989. We conclude that the payments made in 1982 were also made to Thomas Lisle, Amy Albrecht, and Melinda Ballard.

FN31. Approximately $4,000 per month was paid to the Ballard and Lisle children. IRA made distributions to KWJ Corp. and KWJ partnership that were also approximately $4,000 a month. The money distributed to KWJ Corp. and KWJ partnership was never repaid during the years in question, and no interest was ever paid on the amounts outstanding.

FN32. The record is unclear whether all four each received $9,000, or whether Thomas Lisle, Amy Albrecht, and Karen Hart each received $12,000. Melinda Ballard testified that she resigned from KWJ Co. in 1988. If that was the case, then of the $36,000 paid by KWJ Co. in 1989, Thomas Lisle, Amy Albrecht, and Karen Hart each received $12,000. If Melinda Ballard did not resign, then each of the four children received $9,000 during 1989. Thomas Lisle and Amy Albrecht together received at least $18,000 during 1989, and Ballard's children received at least $12,000.

FN33. The Morkan Trust is named after Kanter's father,

Morris Kanter.

FN34. No treasurer was listed for 1985.

FN35. No treasurer was listed from 1985 through 1990, and no vice president was listed from 1983 through 1987 and in 1990.

FN36. In 1979, the CMB Cinema Trust was divided into 10 separate trusts.

FN37. In 1983, HELO was a subsidiary of Holding Co. On Aug. 31, 1984, Kanter as trustee of the ARO Trusts became the owner of 100 percent of HELO's voting stock.

FN38. It is not clear from the record whether HELO made the distributions to the Basking Ridge and Summit trusts during 1983 or at some earlier time.

FN39. IRA had transferred the interest in the 1984 Development partnership as part of the 1983 writeoff. The value of the interest for that transfer was $86,400.

FN40. MAF was a wholly owned subsidiary of Computer Placement Services, Inc. (Computer Placement Services).

FN41. By Sept. 1, 1985, HELO was no longer a subsidiary of Holding Co.

FN42. During the bankruptcy proceeding for Administration Co., the only documents that bankruptcy counsel for Administration Co. may have received from Administration Co. were copies of its tax returns. He received none of the books and records of the clients of Administration Co. The documents sought by the summons which was the subject of the summons enforcement proceeding did not ask for the tax returns of Administration Co. The summons sought the books and records relating to transactions involving the

Kanters for the years 1983, 1985, 1986, 1987 and 1988. These records were not given to the bankruptcy counsel. They were given to Kanter.

FN43. The Court of Appeals stated: "It is apparent that the Government is interested in transactions in which Kanter and his family and their investment vehicles are involved and not just in the terms of the custodianship arrangement." United States v. Administrative Enters., Inc., 46 F.3d 670, 673 (7th Cir.1995).

FN44. Walter Ross was senior vice president of finance of Century Development Corp. at the time of Schnitzer's purchase of Fletcher Emerson. Ross testified that it was customary in the industry to base the purchase price of a service corporation such as Fletcher Emerson on the pretax income of the company.

FN45. Under the stock agreement entered into by Century and IRA when IRA purchase the Schnitzer-PMS stock, upon the death of the last to die of Kanter, Weisgal, and Schott, Century had the option to purchase IRA's stock. The purchase price for IRA's stock under the agreement was an amount in excess of 8 times Schnitzer-PMS's average pretax income. Eight times Schnitzer-PMS pretax income for 1977 is over $3.6 million.

FN46. Roland Burrows, chief office and president of Schnitzer-PMS during the years at issue, testified that the business of the corporation grew at about 25 percent each year until about 1976. The rate of growth slowed substantially after that time because of the size of the corporation.

FN47. Under the stock agreement entered into by Century and IRA when IRA purchased the Schnitzer-PMS stock, the purchase price for IRA's stock was an amount in excess of 8 times Schnitzer-PMS's average pretax income. Eight times

Schnitzer-PMS pretax income from 1976 to 1978 ($533,500) is more than $4.2 million. Based on that value all of the stock in the corporation was worth more than $8 million.

FN48. The Court, however, is not convinced that Cedilla Co. was organized for any purpose other than to serve as a vehicle for Kanter's various tax avoidance schemes.

FN49. Keating's preferred stock was redeemed in 1977.

FN50. Sec. 1.482-1A(b)(1), Income Tax Regs provides:
The purpose of section 482 is to place a controlled taxpayer on a tax parity with an uncontrolled taxpayer, by determining, according to the standard of an uncontrolled taxpayer, the true taxable income from the property and business of a controlled taxpayer. The interests controlling a group of controlled taxpayers are assumed to have complete power to cause each controlled taxpayer so to conduct its affairs that its transactions and accounting records truly reflect the taxable income from the property and business of each of the controlled taxpayers. If, however, this has not been done, and the taxable incomes are thereby understated, the district director shall intervene, and, by making such distributions, apportionments, or allocations as he may deem necessary of gross income, deductions, credits, or allowances, or of any item or element affecting taxable income, between or among the controlled taxpayers constituting the group, shall determine the true taxable income of each controlled taxpayer. The standard to be applied in every case is that of an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer.

Nos. 01-17249-GG, 01-17251-GG ,01-172 3-GG
01-17255-GG, 01-17256-GG, 01-17257 GG .

IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

CLAUDE M. BALLARD and MARY B. BALLARD,
Petitioners-Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellees.

Appeals from a Decision of the United States Tax Court

ON PETITION(S) FOR REHEARING AND PETITION(S)
FOR REHEARING EN BANC
(Opinion 11th Cir., 19 , F.2d).

Before; HULL, FAY and GIBSON*, Circuit Judges.

PER CURIAM:

The Petition(s) for Rehearing are DENIED and no Judge in regular active service on the Court having requested that, the Court be polled on rehearing en banc (Rule 35, Federal Rules of Appellate Procedure), the Petition(s) for Rehearing En Banc are DENIED.

ENTERED FOR THE COURT:
UNITED STATES CIRCUIT JUDGE

Footnotes

*Honorable John R. Gibson, United States Circuit judge for the Eight Circuit, sitting by designation.

Docket Nos. 43966-85, 712-86, 45273-86, 1350-87, 31301-87, 33557-87, 3456-88, 30830-88, 32103-88, 27444-89, 16421-90, 25875-90, 26251-90, 20211-91, 20219-91, 21555-91, 21616-91, 23178-91, 24002-91, 1984-92, 16164-92, 19314-92, 23743-92, 26918-92, 7557-93, 22884-93, 25976-93 and 25981-93

UNITED STATES TAX COURT

INVESTMENT RESEARCH ASSOCIATES, LTD., AND SUBSIDIARIES, et al.,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECLARATION OF RANDALL G. DICK

Randall G. Dick, for his Declaration under penalty of perjury, pursuant to 28 U.S.C. 1746, states as follows:

1. I am of full age, and if called to testify, would be competent to give the testimony as to the following matters.

2. I am counsel for Investment Re arch Associates, Ltd. and Subsidiaries and for Burton and Naomi Kanter.

3. In its Opinion in this matter filed on December 15, 1999 (T.C. Memo 1999-407) the U.S. Tax Court concluded, with respect to issue 1, that payments made by Hyatt, Frey, Schaffel, Schnitzer and Eulich (the "Five") were taxable to the individual Petitioners and the individual Petitioners were liable for the fraud additions to tax and penalty with respect to such income. (Opinion, 226-319).

4. Subsequent to the issuance of the Tax Court's

Opinion, Declarant was informed by two judges of the Tax Court, that in his original report submitted to the Chief Judge pursuant to Rule 183(b), Special Trial Judge D. Irwin Couvillion concluded that payments made by the Five were not taxable to the individual Petitioners and that the fraud penalty was not applicable.

5. In my conversations with the judges of the Tax Court, I was told the following: That substantial sections of the opinion were not written by Judge Couvillion, and that those sections containing findings related to the credibility of witnesses and findings related to fraud were wholly contrary to the findings made by Judge Couvillion in his report. The changes to judge Couvillion's findings relating to credibility and fraud were made by Judge Dawson.

6. Judge Dawson`s revisions resulted in a finding that over nine million dollars is taxable to the individual Petitioners. This finding based upon credibility of witnesses, results in liability of the individual Petitioners for tax, penalties and interest in an amount in excess of $30,000,000.

7. I confirmed the information, in paragraphs 4 and 5 above with another judge of this Court, who informed me that in fact, the Opinion was changed, and that to his knowledge, it was the first time the Tax Court had made an outright rejection of credibility findings made by a Special Trial judge.

8. I was also told by a judge of the Tax Court that the changed sections of the report were written in such a way so that wherever there was the "slightest issue of doubt, it went against" the Petitioners.

I declare under penalty of perjury that the foregoing is true and correct and that this Declaration is executed in San Francisco, California on August 21, 2000.

RANDALL G. DICK

Docket Nos. 43966-85, 712-86, 45273-86, 1350-87, 31301-87, 33557-87, 3456-88, 30830-88, 32103-88, 27444-89, 16421-90, 25875-90, 26251-90, 20211-91, 20219-91, 21555-91, 21616-91, 23178-91, 24002-91, 1984-92, 16164-92, 19314-92, 23743-92, 26918-92, 7557-93, 22884-93, 25976-93 and 25981-93

UNITED STATES TAX COURT

INVESTMENT RESEARCH ASSOCIATES, LTD., AND SUBSIDIARIES, et al.,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ORDER

For cause, it is

ORDERED: That these cases are reassigned from Special Trial Judge D. Irvin Couvillion to Judge Howard A. Dawson, Jr., for disposition.

After the Special Trial Judge submitted a report, as required by Rule 183(b), Tax Court Rules of Practice and Procedure, these cases were referred to Judge Dawson on September 2, 1998, for review and, if approved, for adoption.

Mary Ann Cohen
Chief Judge

Dated; Washington, D.C.
December 15, 1999

Docket Nos. 43966-85, 712-86, 45273-86, 1350-87, 31301-87, 33557-87, 3456-88, 30830-88, 32103-88, 27444-89, 16421-90, 25875-90, 26251-90, 20211-91, 20219-91, 21555-91, 21616-91, 23178-91, 24002-91, 1984-92, 16164-92, 19314-92, 23743-92, 26918-92, 7557-93, 22884-93, 25976-93 and 25981-93

UNITED STATES TAX COURT

INVESTMENT RESEARCH ASSOCIATES, LTD., AND SUBSIDIARIES, et al.,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ORDER

On August 22, 2000, petitioners filed a motion for Reconsideration of the Court's Denial of Petitioners' Motion for Access to Original Special Trial Judge Report Prepared Under Rule 183(b) or, In The Alternative, for a New Trial. This is the third time petitioners have filed a motion seeking access to "all reports, draft opinions, or similar documents prepared and delivered to the Court pursuant to Rule 183(b)". By Order dated April 26, 2000, the Court denied petitioners' motion in all respects setting forth its reasons. In that Order it was stated that the provisions of section 7443A(b) (4), Internal Revenue Code, and Rule 183, Tax Court Rules of Practice and Procedure, were followed by the Court. See Freytag v. s ion , 501 U.S. 868, 871-875 (1991), affg. 904 F.2d 1011, 1014-1015 (5th Cir. 1990). Section 7443A(b) (4) provides that the chief judge may assign to special trial judges "any other proceeding which the chief judge may designate, to be heard by the special trial judges of the court". Rule 183, first adopted effective January 16,

1984, provides as follows:

(a) Trial and Briefs: A Special Trial Judge shall conduct the trial of any such case assigned for such purpose. After such trial, the parties shall submit their briefs in accordance with the provisions of Rule 151. Unless otherwise direct, no further briefs shall be filed.

(b) Special Trial Judge's Report: After all the briefs have been filed by all the parties or the time for doing so has expired, the Special Trial Judge shall submit a report, including findings of fact and opinion, to the Chief Judge, and the Chief Judge will assign the case to a Judge or Division of the Court.

(c) Action on the Report: The Judge to whom or the Division to which the case is assigned may adopt the Special Trial Judge's report or may modify it or may reject it in whole or in part, or may direct the filing of additional briefs or may receive further evidence or may direct oral argument, or may recommit the report with instructions. Due regard shall be given to the circumstance that the Special Trial Judge had the opportunity to evaluate the credibility of witnesses, and the findings of fact recommended by the Special Trial Judge shall be presumed to be correct.

The Note to Rule 183 states:

"The prior provisions for service of the Special Trial Judge's report on each party and for the filing of exceptions to that report have been deleted". 81 T.C. at 1070. The reason for the Note was that procedures which existed before January 16, 1984, were changed by Rule 183.

The present procedures of Rule 183 were expressly approved by the Supreme Court in Freytag v. Commissioner, 501 U.S. at 874, where it is stated that special trial judges have the

authority to hear cases and prepare proposed findings and opinions, but that they lack the authority to decide cases under section 7443A(b) (4) because that is "reserved exclusively for judges of the Tax Court".

Also in the Court's order dated April 26, 2000, we stated:

Therefore, petitioners' motion requesting access to any internal Court documents, including any preliminary drafts of reports or opinions, documents, memorandums or notes by judges, special trial judges or employees of the Court, will be denied. In any event such materials are confidential and not subject to production because they relate to the internal deliberative processes of the Court.

On May 30, 2000, the Court denied petitioners' motion to place the original report of the Special Trial Judge under seal and made a part of the record so that it would be available to a court of appeals for review.

In the present motion seeking again access to "all reports, draft opinions or similar documents" prepared pursuant to Rule 183(b), Randall G. Dick, counsel for petitioners Investment Research Associates, Ltd., and Burton W. Kanter and Naomi R. Kanter, for the first time in the motion and in his declaration attached thereto, has made general assertions, without specificity, that two on three judges of the Court informed him that an original report of Special Trial Judge Couvillion "concluded that payments made by the Five were not taxable to the individual Petitioners and that the fraud penalty was not applicable". Although Mr. Dick states in his declaration that some judges commented about the procedures involved in handling these cases, whatever may have been said to Mr. Dick is irrelevant and immaterial.

The only official Memorandum Findings of Fact and

Opinion by the Court in these cases is T.C. Memo. 1999-407, filed on December 15, 1999, by Special Trial Judge Couvillion, reviewed and adopted by Judge Dawson, and reviewed and approved by former Chief Judge Cohen.

Judge Dawson states and Special Trial Judge Couvillion agrees, that, after a meticulous and time-consuming review of the complex record in these cases, Judge Dawson adopted the findings of fact and opinion of Special Trial Judge Couvillion, that Judge Dawson presumed the findings of fact recommended by Special Trial Judge Couvillion were correct, and that Judge Dawson gave due regard to the circumstance that Special Trial Judge Couvillion evaluated the credibility of witnesses.

Petitioners have requested that Judge Dawson recuse himself from further consideration of these cases. He declines to do so. Chief Judge Wells upon review of the motion and consideration of the matter concludes that there are no valid grounds for compelling Judge Dawson to recuse himself.

In the alternative, petitioners have moved that the Court order a new trial before a new Tax Court judge. Chief Judge wells views this as a motion without sufficient grounds to support it. Therefore, a new trial before another judge of the Court will not be ordered. Once the decisions are entered, petitioners may appeal the decisions if they so choose. Accordingly, it is

ORDERED that Petitioners' Motion for Reconsideration of the Court's Denial of Petitioners' Motion for access to original Special Trial Judge Report Prepared Under Rule 183(b) or, In The Alternative, For a New Trial is denied.

Thomas B. Wells
Chief Judge

Howard A. Dawson, Jr.
Judge

D. Irvin Couvillion
Special Trial Judge

Dated: Washington, D.C.
August 30, 2000